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No. 07-__06135 [illegible] 2007

In The OFFICE OF THE CLERK
Supreme Court of the United States

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POSITIVE SOFTWARE SOLUTIONS, INC.,

Petitioner,

v.

NEW CENTURY MORTGAGE CORPORATION,
NEW CENTURY FINANCIAL CORPORATION,
ECONDUIT CORPORATION, THE ANYLOAN
COMPANY, JEFF LEMIEUX, AND FRANK NESE,

Respondents.

◆

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

◆

PETITION FOR A WRIT OF CERTIORARI

◆

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QUESTION PRESENTED

Nearly forty years ago, this Court interpreted the Federal Arbitration Act to require "that arbitrators disclose to the parties any dealings that might create an *impression* of possible bias." *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 149 (1968) (emphasis added). Six Justices agreed in that case that an arbitrator's *actual* bias is irrelevant in determining whether an award should be vacated on non-disclosure grounds.

While several circuits – most clearly the Ninth – have faithfully adhered to the *Commonwealth Coatings* rule in arbitrator non-disclosure cases, others have been confused and divided over the correct interpretation of this Court's decision. Most recently, the Fifth Circuit sitting en banc held – at complete odds with *Commonwealth Coatings* – that an award should be vacated only if the arbitrator had a "significant *compromising* connection to the parties."

Against this backdrop, the question presented is: Under the Federal Arbitration Act, what standard should a district court apply in deciding whether to vacate an arbitration award based on the arbitrator's failure to disclose a relationship with a party or counsel to the proceeding.

RULE 29.6 STATEMENT

Positive Software Solutions, Inc. ("Positive Software") is a privately-held company. No parent or publicly-held company owns 10% or more of the company's stock.

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OPINIONS BELOW

The en banc opinion of the Fifth Circuit Court of Appeals (Pet. App. 1a) is reported at 476 F.3d 278 (2007). The panel opinion of the Fifth Circuit Court of Appeals (Pet. App. 36a) is reported at 436 F.3d 495 (2006). The opinion of the district court (Pet. App. 57a) is reported at 337 F. Supp. 2d 862 (N.D. Tex. 2004).

JURISDICTION

The en banc opinion of the Fifth Circuit was issued on January 18, 2007 (Pet. App. 1a). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

The Federal Arbitration Act provides, in relevant part:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration –
>
> . . . .
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;

9 U.S.C. § 10(a).

STATEMENT OF THE CASE

This case concerns the correct standard to be applied in deciding whether to vacate an arbitration award when the arbitrator fails to disclose a relationship with a party or an attorney to the proceeding. In this Court's one and only decision on the issue of arbitrator non-disclosure, *Commonwealth Coatings Corp. v. Continental Casualty Corp.*, 393 U.S. 145 (1968), six Justices voted to overturn an arbitration award on account of the arbitrator's undisclosed relationship with one of the parties. All six Justices agreed that the arbitrator was "entirely fair and impartial," *id.* at 151 n* (White, J., concurring); *see also id.* at 147 ("[W]e have no reason, apart from the undisclosed business relationship, to suspect him of any improper motives."), but decided that the arbitrator's non-disclosure alone constituted "evident partiality" within the meaning of the Federal Arbitration Act, 9 U.S.C. § 10(a).

Sitting en banc, the Fifth Circuit in this case nevertheless held that an arbitrator's failure to disclose a material past relationship with counsel to the proceeding is an insufficient basis for vacatur, and that an award can be vacated only if the arbitrator's "bias was clearly evident." (Pet. App. 5a.) While acknowledging that the arbitrator here failed to disclose his longstanding relationship with attorneys for one party to the arbitration, the Fifth Circuit reversed the district court's decision to vacate on the ground that the undisclosed relationship was not a "compromising" one. (Pet. App. 9a, 15a.) Five judges forcefully dissented. (Pet. App. 16a.)

A. *Commonwealth Coatings*

In *Commonwealth Coatings Corp. v. Continental Casualty Corp.*, 393 U.S. 145 (1968), one of three arbitrators failed to inform the parties that he had engaged in "sporadic" business dealings "from time to time at irregular intervals" with one of the parties to the proceeding. *Id.* at 146. The parties and the Justices unanimously agreed that the arbitrator was fair and impartial – in fact, the petitioner never even claimed "that the third arbitrator was actually guilty of fraud or bias in deciding this case." *Id.* at 147; *see also id.* at 151 n.* (White, J., concurring) (noting the district court's unquestioned finding that "the arbitrator in this case was entirely fair and impartial"); *id.*

at 154 (Fortas, J., dissenting) (observing that "the complaining party disclaims any imputation of partiality, bias, or misconduct"). To the contrary, the petitioner admitted that he probably would not have objected to the arbitrator's selection even if he had known about the undisclosed relationship with his opponent. *Id.* at 153 (Fortas, J., dissenting).

Writing the "opinion of the Court," 393 U.S. at 145 – a "majority" opinion that Justice White was "glad to join," 393 U.S. at 150, 151 n.* (White, J., concurring) – Justice Black examined section 10 of the United States Arbitration Act (now the Federal Arbitration Act ("FAA")), which "authorize[s] vacation of an award . . . '(w)here there was evident partiality . . . in the arbitrators,'" and decided that in the context of non-disclosure, "evident partiality" can be established without evidence of an arbitrator's actual bias or "improper motives." *Id.* at 147. Under Justice Black's interpretation, "evident partiality" exists simply by virtue of an arbitrator's failure to "disclose to the parties any dealings that might create an impression of possible bias." *Id.* at 149.

Justices Black's majority opinion and Justice White's concurrence examined the arbitral disclosure issue objectively from the standpoint of the parties selecting a neutral arbitrator to decide their case, and created a standard that evaluates not whether the arbitrator actually *is* biased but whether he "might reasonably be *thought* biased" by a party to the arbitration. 393 U.S. at 150 (emphasis added). They recognized the virtually unlimited power that arbitrators have – "completely free rein to decide the law as well as the facts" without the safeguard of "appellate review" – and the consequent importance of enforcing the "simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias," *id.*, and letting the parties determine the significance of those dealings for themselves. In

Justice White's words, if parties are apprised of all but "trivial" relationships with the parties or counsel to the proceeding, they can be the "judge[s] of the arbitrator's impartiality," "free to reject the arbitrator or accept him with knowledge of the relationship and continuing faith in his objectivity." 393 U.S. at 151 (White, J., concurring). Fundamentally, both Justices understood that a broad disclosure rule gives the parties, the "architects of their own arbitration process," *id.*, an informed, meaningful choice.

B. Factual Background And Procedural History

The facts of this case differ in several significant respects from the facts of *Commonwealth Coatings*. Whereas in *Commonwealth Coatings* the parties' contract provided that two party-appointed arbitrators would select a third "supposedly neutral" arbitrator, 393 U.S. at 146, here the parties contractually agreed to directly select a single arbitrator to decide their dispute. Whereas in *Commonwealth Coatings* the arbitration was not "subject to the rules of the American Arbitration Association ("AAA")," *id.* at 152 (Fortas, J., dissenting), here the parties *did* agree to be bound by and to follow AAA rules, which require that arbitrators disclose "any past or present relationship with the parties or their representatives" (PSSRE7 at 17 (AAA Commercial Rule R-16(a)). Whereas in *Commonwealth Coatings*, the arbitrator in question was never asked to disclose any relationships with the parties or attorneys before him, *id.* at 152 (Fortas, J., dissenting), here the AAA asked the arbitrator – five or six times – to disclose all such relationships and the arbitrator affirmatively stated that he had "nothing to disclose." Whereas in *Commonwealth Coatings* there was "no suggestion that the nondisclosure was calculated," *id.* at 154 (Fortas, J., dissenting), here there was such a suggestion – Positive Software even lodged a claim of actual bias against the arbitrator.[1] And, whereas in *Commonwealth Coatings* the non-disclosure was practically harmless because the petitioner probably would not have objected in any event, here it is undisputed that Positive Software never would have agreed to the arbitrator's appointment had it known about his relationship with opposing counsel.

The specific facts of this case are detailed below.

1. Positive Software Brings Suit Against New Century, Which The District Judge Considers Substantially Likely To Succeed.

In 2001, Positive Software, a firm that develops and markets computer-software products for the mortgage industry, licensed "LoanForce," a software program, to New Century Mortgage Corporation ("New Century"), a mortgage company. (1R50-53.) Without Positive Software's knowledge or consent, New Century proceeded to copy LoanForce – in direct violation of the parties' agreement and applicable copyright law – for the purpose of creating a new program that it could use in lieu of Positive Software's product. (1R63, ¶ 59.)

Positive Software timely filed a copyright infringement complaint against New Century in federal district court (1SuppR49-78), and on April 28, 2003, United States District Court Judge David C. Godbey granted Positive Software's motion to preliminarily enjoin New Century from using LoanForce (1R164). The district court held that Positive Software had shown a substantial likelihood of success on the merits of its copyright infringement claim. (*Id.* at 152-56.)

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[1] As Judge Reavley observed in his dissent, the arbitrator in this case "ridiculed Positive Software's claim," and the district court took note of the arbitrator's "disdain." (Pet. App. 23a.)

2. The Case Is Sent To Arbitration, And Positive Software Is Denied Any Form Of Relief.

Over Positive Software's objection, its claims were submitted to arbitration. (1R164.) By the parties' agreement, arbitrator selection was governed by the rules and procedures of the AAA. (16PSSApp7864.) When the parties could not agree on any of the arbitrators in the initial list of names, the AAA provided an additional five nominees. (1PSSApp117-160.) Positive Software objected to two of the five, and ranked Peter Shurn first on its list of acceptable candidates. (*Id.* at 147-60.) Shurn was ultimately selected as the sole arbitrator in this case. (*Id.* at 164; PSSRE3.)

Immediately after Shurn was selected, the AAA informed Shurn of the names of the parties and counsel in the case – specifically indicating that Susman Godfrey lawyer Ophelia Camiña had been designated New Century's co-lead arbitration counsel (PSSRE3) – and repeatedly urged him to disclose any connection to the parties or counsel to the proceeding. The first "important reminder" appeared in bold typeface and surrounded by asterisks in a June 18, 2003 letter from the AAA, and advised Shurn of his "obligation to disclose any circumstance likely to affect impartiality or create an appearance of partiality." (*Id.*) That same "important reminder" was highlighted in subsequent correspondence from the AAA: a June 23 letter confirming Shurn's agreement to serve and a June 26 letter informing Shurn of an upcoming preliminary hearing. (PSSRE4; PSSRE6.)

The AAA later presented Shurn with a "Notice of Appointment," which also advised him to "disclose any past or present relationship with the parties, their counsel, or potential witnesses, direct or indirect, whether financial, professional, social or of any other kind." (PSSRE5 at 12050.) To help arbitrators understand the extent of their disclosure obligations, the Notice of Appointment included twelve questions, one of which asked, "Have you had any professional or social relationship with counsel for any party in this proceeding or firms for which they work?" (*Id.*)

Yet another form, the AAA's Arbitration Disclosure Form, asked Shurn to "disclose any past or present relationship with the parties or their counsel." (PSSRE4.) That Disclosure Form also contained the Arbitrator's Oath, which binds arbitrators to abide by the AAA's Code of Ethics. (PSSRE5.) Both the 1977 and 2004 versions of the Code mirror the language of *Commonwealth Coatings*, specifically instructing arbitrators to disclose "[a]ny known existing or past financial, business, professional or personal relationships *which might reasonably affect impartiality or lack of independence in the eyes of any of the parties. For example, prospective arbitrators should disclose any such relationships which they personally have with any party or its lawyer. . . .* " (PSSRE8 at 11999 (emphasis added).)

As the district court later found, Shurn had been involved in an "extensive" professional relationship with New Century's co-lead arbitration counsel, Ophelia Camiña, and other senior partners at her firm, Susman Godfrey. (Pet. App. 100a.) For nearly a year, both Shurn and Camiña personally represented Intel Corporation ("Intel") in the same matter, and their names appeared together on numerous pleadings. (*See infra*, pp. 9-10.) Shurn's relationship with other Susman Godfrey attorneys, the district court recognized, was undisputed. (Pet. App. 86a.) Nevertheless, when repeatedly asked by the AAA whether he had any "past or present relationship with the parties or their counsel," Shurn emphatically answered – even once under oath – that he had "nothing to disclose." (PSSRE5 at 12050; PSSRE4; PSSRE5.)

On May 5, 2004, following a seven-day hearing, Shurn rejected every one of Positive Software's claims. Despite the district court's finding that Positive Software had a substantial likelihood of success on the merits of its copyright infringement claim (1R152-56), Shurn ordered that Positive Software take nothing (RE5 at 85-86) and allowed New Century to recover $1.5 million in attorneys' fees, and $11,500 on its counterclaim (*id.* at 85). Shurn even refused to order that New Century return to Positive Software the software that New Century admitted it did not own – the original licensed program.

3. The District Court Vacates The Award After Finding That Peter Shurn Had An "Extensive" Professional Relationship With Susman Godfrey "Over Years In High Profile Litigation," But Never Disclosed It To Positive Software.

Finding it impossible to square Shurn's rulings with the parties' licensing agreement, the underlying record, and the district court's decision that Positive Software had a substantial likelihood of success on the merits, Positive Software conducted a detailed investigation into Shurn's background. (Pet. App. 88a.) It discovered that Shurn and his former law firm had been co-counsel in an important, lengthy patent case with Susman Godfrey and Ophelia Camiña in particular. (Pet. App. 84a.)

Invoking the district court's jurisdiction under 9 U.S.C. § 10(a), Positive Software immediately moved to vacate the arbitration award based, *inter alia*, on Shurn's failure to disclose information creating a reasonable impression of bias. (6Supp2R1363-74.) Positive Software supported its motion with evidence that it only discovered Shurn's relationship with Susman Godfrey after the arbitration, and that it never would have agreed to

Shurn's selection had it known about his longstanding relationship with opposing counsel. (PSSRE9 at 12030-31, ¶ 14; PSSRE10 at 12038, ¶¶ 8-9.)

On September 28, 2004, the district court granted Positive Software's motion and vacated Shurn's award based on its finding that Susman Godfrey and Shurn's law firm of twenty years, Arnold White & Durkee ("Arnold White"), had represented Intel in "protracted patent litigation for seven years." (Pet. App. 85a.) The record revealed that both Susman Godfrey and Arnold White had been significantly involved in the Intel case: Susman Godfrey had handled four related Intel actions, Arnold White had handled five, and the two firms had acted as co-counsel in three different matters.[2] Lawyers from both firms had frequently signed pleadings on Intel's behalf – pleadings that listed both firms as counsel of record. (*See, e.g.*, 1PSSApp257-58; *id.* at 183; *id.* at 199; *id.* at 249; *id.* at 260; *id.* at 411-14.)

The evidence further demonstrated that Ophelia Camiña, New Century's co-lead arbitration counsel in the case at bar, and Peter Shurn, a member of Arnold White, were major players in the litigation. Camiña was counsel of record in three Intel matters (RE6 at 167), and Shurn handled two Intel cases (*Cyrix v. Intel*, No. 4:90-cv-00264; *Cyrix v. Intel*, No. 4:93-cv-00093). For nearly a year, Shurn and Camiña personally represented Intel in the same matter, *Cyrix v. Intel*, No. 4:90-cv-00264. Their names appeared side-by-side on ten different pleadings – two of which were signed by Shurn himself. (1PSSApp312; *id.* at

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[2] *Cyrix v. Intel*, No. 4:90-cv-00264 (Arnold White and Susman Godfrey); *Intel v. Cyrix*, No. 3:90-cv-02856 (Arnold White); *Cyrix v. Intel*, No. 4:92-cv-00052 (Arnold White and Susman Godfrey); *Intel v. Cyrix*, No. 3:92-cv-00590 (Arnold White and Susman Godfrey); *Intel v. Cyrix*, No. 4:92-cv-00123 (Susman Godfrey); and *Cyrix v. Intel*, No. 4:93-cv-00093 (Arnold White).

415-19; *id.* at 182-84; *id.* at 185-200; *id.* at 241-42; *id.* at 243-44; *id.* at 251-56; *id.* at 298-99; *id.* at 316-26; *id.* at 328-54; *id.* at 379-85.)

a. The district court discredits the testimony of New Century's only witness, Ophelia Camiña.

The only witness testimony that New Century proffered in opposition to Positive Software's motion to vacate was the four-page affidavit of Ophelia Camiña, which the district court largely dismissed as not credible. Notwithstanding Camiña's testimony that she "never met with or talked to Shurn" prior to the arbitration, and that she and Shurn "never attended any meetings together; never attended any depositions together; never participated in any telephone calls together; never participated in any hearings together; never worked on any pleadings together; and never participated in any trial together" (RE6 at 168), the court concluded that their relationship was "extensive" (Pet. App. 100a). Likewise, the district court gave no credence to Camiña's insistence that her involvement in the Intel litigation "ceased" in June 1992 – two months before Shurn formally entered the case (RE6 at 168), noting that Camiña appeared on pleadings with Shurn as late as June 1993 (Pet. App. 85a).

Also, while Camiña denied in her affidavit that anyone at Susman Godfrey "has currently or in the past, had any professional or personal relationship with Shurn" (RE6 at 169), the district court found that Shurn's relationship with Susman Godfrey – and the attorneys who worked on the Intel case in particular – was beyond dispute. (Pet. App. 86a). The record specifically reveals a close working relationship between Shurn and name partner Stephen Susman. In September 1992, Susman wrote a letter to counsel for Cyrix announcing the witnesses that

Intel intended to call at trial, and copied only three other attorneys – one of whom was his co-counsel Shurn. (1PSSApp257-58.) Shurn and Susman were also two of only five attorneys in the case served with critical pleadings like Cyrix's amended complaint. (*Id.* at 225-39; *see also id.* at 220-24 (Cyrix's Motion for Leave to File Amended Complaint; *id.* at 247-50 (Agreed Stipulation to Extend Response Dates).) Susman was even designated the "attorney in charge" of the litigation on at least two pleadings (1PSSApp254-55; *id.* at 379-85), making it inconceivable that two of the lead Intel lawyers had no professional relationship. Tellingly, New Century never submitted an affidavit from Stephen Susman – or any other Susman Godfrey lawyer – disclaiming a professional or personal relationship with Shurn.

The district court's first-hand evaluation of Camiña's testimony was informed by repeated observations of her conduct and credibility. Before ruling on Positive Software's motion to vacate the arbitration award, the district court found that New Century had – with Camiña's knowledge – violated the protective order the court had issued to guard the parties' confidential information during the pendency of the action. (Pet. App. 65-66, 80.) In fact, Camiña was aware that New Century's Chief Technology Officer had lied at his deposition about his continued use of LoanForce, and yet "took no steps to correct [his] deposition testimony." (Pet. App. 66a.)

In addition to violating the protective order, Camiña and New Century withheld critical documents from Positive Software – committing what the district court recognized as the most pernicious form of "discovery abuse." (Pet. App. 83a-84a.) Although "Positive Software had consistently sought in discovery the earliest version of LoanForce available," New Century refused without explanation to produce the original version – with dire consequences for Positive Software's case before the arbitrator. (Pet. App. 67a.) As it turned out, New Century *had* the earliest version of LoanForce in its possession during the entire arbitration and Camiña knew it. (Pet. App. 83a.) "Amazingly, [Camiña] nonetheless failed to produce the script for the original version of LoanForce." (Pet. App. 67a-68a.) The district court was "most distressed" by the prevarications of Camiña and her client. (Pet. App. 83a.)

b. The district court believes the testimony of Positive Software's witnesses.

By contrast, the district court accepted the undisputed testimony of Positive Software's witnesses, that "[a]t no time before, during, or after the arbitration" did Shurn disclose his longstanding professional relationship with Susman Godfrey or Ophelia Camiña in particular. (Pet. App. 88a.) The district court also credited Positive Software's representation "that it did not become aware of this relationship until it did additional background investigation on the Arbitrator following the award in an attempt to understand a result that it did not believe was consistent with the record." (Pet. App. 88a.) Finally, the district court believed that Shurn never would have been selected as the arbitrator in this case – and compensated for his services at a rate of $1,795 per day (24PSSApp12059) – had Positive Software been aware of the significant relationship between Shurn and Susman Godfrey. (Pet. App. 86a; PSSRE9 at 12030-31; PSSRE10 at 12038.)

Having assessed the witnesses' credibility and weighed all the evidence, the district court reached the "firm conviction" that "any reasonable trial lawyer would want to know of an arbitrator-candidate's prior association with opposing counsel before choosing him as the sole arbitrator." (Pet. App. 99a-100a.) Although Positive Software had requested discovery to uncover the full extent of the relationship between Shurn and Susman Godfrey attorneys, the district court concluded that it had seen enough and that the undisclosed facts already of record created a reasonable impression of partiality that required vacatur under *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968). (Pet. App. 99a-100a.)

4. The Panel Applies the *Commonwealth Coatings* "Reasonable Impression Of Bias" Standard And Unanimously Affirms The District Court's Decision.

Judges Reavley, Garza and Benavides unanimously affirmed the district court's decision, concluding that "the district court properly vacated the arbitration award by reason of Shurn's failure to reveal to the parties his prior relationship with Susman Godfrey and Camiña." (Pet. App. 53a.) While noting that the "case law in this area is confusing and complicated" (Pet. App. 43a), and that "some lower federal courts have seen a conflict" between Justice Black's majority opinion and Justice White's concurrence in *Commonwealth Coatings* (Pet. App. 45a), the panel nevertheless concluded that "both opinions share the same goal – full disclosure at the outset" (Pet. App. 46a, n.29). In "maintaining faithfulness to the Court's opinion in *Commonwealth Coatings*," the panel held:

> [A]n arbitrator selected by the parties displays evident partiality by the very failure to disclose facts that might create a reasonable impression of the arbitrator's partiality. *The evident partiality is demonstrated from the nondisclosure, regardless of whether actual bias is established.*

(Pet App. 49a (emphasis added).) The panel added that "[w]hile an arbitrator to be selected by the parties need not disclose relationships that are trivial, an arbitrator should always err in favor of disclosure." (Pet. App. 51a.)

Applying that standard without disturbing the district court's findings of fact – which in any event were never challenged on appeal – the panel concluded that "Shurn's past professional relationship with Susman Godfrey and Camiña might have conveyed an impression of possible partiality to a reasonable person":

> *It is not hard to think that Positive Software might not want to employ his services in an arbitration hearing with New Century once it discovered his prior relationship with the law firm and counsel representing New Century.* On the other hand, Positive Software might decide that Shurn's qualifications as an arbitrator outweigh whatever concerns it might have. *The point is simply that the information should have been disclosed* to Positive Software so that it could make that decision. The integrity of the arbitral process demands no less.

(Pet. App. 52a-53a (emphasis added).)

5. A Majority Of The En Banc Court Applies An "Actual Bias" Standard, Reversing The District Court, And Five Judges Forcefully Dissent, Championing *Commonwealth Coatings*.

The Fifth Circuit's rehearing en banc resulted in a majority and dissenting opinions with two radically divergent views of the correct standard for vacating an arbitration award on non-disclosure grounds.

a. The majority opinion

The en banc majority's decision begins and ends with the language of the FAA, which in its view "seems to require upholding arbitral awards *unless bias was clearly evident* in the decisionmakers." (Pet. App. 5a (emphasis added).) After relegating Justice Black's *Commonwealth*

Coatings majority opinion to "plurality-plus" status (Pet. App. 6a), the en banc majority purported to find support in Justice White's concurring opinion for a standard that evaluates whether "bias was clearly evident in the decisionmakers" – rather than whether the parties were provided sufficient information to act as the "judge[s] of the arbitrator's impartiality," 393 U.S. at 151 (White, J., concurring).

In the en banc majority's view, Justice White's opinion that "trivial" or "insubstantial" relationships need not be disclosed somehow translates that "nondisclosure alone does not require vacatur of an arbitral award for evident partiality," and that "[a]n arbitrator's failure to disclose must involve a *significant compromising* connection to the parties." (Pet. App. 9a.) The en banc majority reasoned that to vacate an award on account of undisclosed facts that create a reasonable impression of bias – as the panel did – "would hold arbitrators to a higher ethical standard than federal Article III judges." (Pet. App. 14a.) Confusing the distinction drawn in Justice White's concurrence between the disclosure rule applicable to arbitrators and the disqualification rule applicable to judges, the en banc majority claimed that arbitrators should not "be automatically disqualified" "by failure to inform the parties of trivial relationships." (Pet. App. 15a (citing *Commonwealth Coatings*, 393 U.S. at 150 (White, J., concurring).) It was never argued, however, that Shurn should be automatically *disqualified* as conflicted judges are – only that he should have disclosed his relationship with New Century's counsel so that Positive Software could evaluate the probability of bias and decide whether to object to his appointment. As Justice White explained, unlike judges who are obligated to recuse themselves upon discovery of a compromising relationship with the parties or their counsel, "arbitrators are not automatically disqualified by a business relationship with the parties before them *if* *both parties are informed of the relationship in advance."* 393 U.S. at 150 (White, J., concurring) (emphasis added).

The majority fully recognized that its decision created a split with the Ninth Circuit's decision in *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994). (Pet. App. 10a.)[3] While *Schmitz*, like the *Commonwealth Coatings* Court, examined the issue of arbitral non-disclosure from a *party* perspective, "mandat[ing] a 'reasonable *impression* of bias' standard (Pet. App. 10a (emphasis added)), the en banc majority evaluated the arbitrator's *actual* bias, holding that "[t]he draconian remedy of vacatur is only warranted upon nondisclosure that involves a significant *compromising* relationship" (Pet. App. 15a (emphasis added)).

b. The dissenting opinions

There were two potent dissents. The first, by Judge Reavley, joined by Judges Wiener, Garza, Benavides and Stewart, faulted the majority for substituting an "actual bias" standard "for the Supreme Court's ruling that dealings that might create only an impression of possible bias must be disclosed." (Pet. App. 18a.) Judge Reavley boldly proclaimed: "I dissent because this court may not overrule a decision of the Supreme Court." (Pet. App. 16a.)

Judge Reavley proffered his own view of *Commonwealth Coatings*, a view radically different from the en banc majority. He first noted that both Justice Black and Justice White "vacated the award even though the arbitrator had been fair and impartial." (Pet. App. 17a.) Judge Reavley then explained that the two opinions are "easily reconciled" because Justice White only "point[ed] out that a trivial relation would not create an impression of possible bias so as to meet the rule stated by Justice Black." (Pet. App. 17a-18a.) Judge Reavley was "confident that Justices White and Marshall knew what they were saying when they joined Justice Black's opinion, and were not describing it as the majority opinion only to be 'magnanimous' as our court now says." (Pet. App. 18a.)

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[3] Although the en banc majority characterized the Ninth Circuit's decision in *Schmitz* as an "outlier" (Pet. App. 10a), other courts have either directly followed *Schmitz* or subscribed to the same interpretation of *Commonwealth Coatings*. (*See infra*, pp. 26-27.)

Like the majority, Judge Reavley recognized the wide chasm between the en banc majority and the Ninth Circuit, which in *Schmitz v. Zilveti* "rejected the view that *Commonwealth Coatings* was only a plurality decision, and applied the non-disclosure rule of the Supreme Court." (Pet. App. 20a.) Judge Reavley pointed out, however, that the Fifth Circuit was not the first to "flounder[] in the wake of *Commonwealth Coatings*" (Pet. App. 21a (quoting Elizabeth A. Murphy, Note, *Standards of Arbitrator Impartiality: How Impartial Must They Be?,* 1996 J. Disp. Resol. 463, 470)), and that other courts have likewise deemed Justice Black's opinion a non-binding plurality without ever explaining how it is "irreconcilable with Justice White's concurrence" (Pet. App. 20a).

Judge Reavley concluded by underscoring "the need to promote the impartiality of arbitrators in this time when that is the favored method of dispute resolution": "It is imperative that we not allow even the good faith or memory of the potential arbitrator to control the disclosure decision for, as the Justices made clear in *Commonwealth Coatings*, it is the protection and reassurance of the party that matters most." (Pet. App. 21a.) He implicitly urged this Court to "understand the wisdom" of its ruling in *Commonwealth Coatings*, "follow that ruling and affirm the judgment vacating this arbitration award." (Pet. App. 25a.)

Judge Wiener, joined by Judge Reavley, "wholeheartedly concur[red]" in Judge Reavley's dissent, but wrote separately to elaborate upon Justice White's observation about the difference between arbitral and judicial proceedings, and the radically different process by which arbitrators and judges are selected. (Pet. App. 26a.) Judge Wiener explained that the "principal benefits" of arbitration – "speed, informality, cost-savings, confidentiality, and services of a decision-maker with expertise and familiarity with the subject matter of the dispute" come at the expense of procedural protections like "the rules of evidence and civil procedure," and "virtually the entire system of appellate review." (Pet. App. 28a.) As for the selection process, federal judges, "full-time dispute resolvers," are "nominated and confirmed only after a rigorous testing of their capabilities, experience, and integrity," and are assigned to a given case "by objectively random or blind assignment through long established court procedures. . . . " (Pet. App. 29a.) Arbitrators, by contrast, sometimes experienced and sometimes not, "are quickly selected by the parties alone, who frequently have unequal knowledge of or familiarity with the full history of potential arbitrators." (Pet. App. 29a.)

Judge Weiner concluded that because parties to an arbitration forfeit the procedural safeguards that attend judicial proceedings, selecting an impartial arbitrator to fairly decide their case is of critical importance – and even more so because unlike in litigation "they alone do the selecting." (Pet. App. 29a.) "As gatekeepers, the parties are charged with guarding against favoritism and prejudice, *a duty that they cannot possibly discharge in the absence of total disclosure*." (Pet. App. 30a-31a (emphasis added).) For parties to have confidence in the arbitrator ultimately selected and "[f]or the system to enjoy credibility," arbitrators must disclose all *potentially* compromising relationships – not simply "significant compromising relationships," as the en banc majority would have it (Pet. App. 32a) – and "leave to the parties the value judgment as to which (if any) among those fully disclosed facts constitutes a basis for rejecting the potential arbitrator for bias or the appearance of bias." (Pet. App. 31a.)

REASONS FOR GRANTING THE PETITION

This case presents a classic candidate for this Court's review. The Fifth Circuit decision on the standard for vacating an arbitral award based on an arbitrator's failure to disclose directly conflicts with the standard this Court established in its only decision in an arbitrator non-disclosure case, *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968). The Fifth Circuit's holding creates a split with the Ninth Circuit, and adds to the general confusion among the circuits over the correct interpretation of *Commonwealth Coatings* and the appropriate standard to be applied in an arbitrator non-disclosure case. This disarray in the circuits casts a shadow over the entire federal arbitration system, as well as the dozens of state systems that piggyback on federal law.

I. THE FIFTH CIRCUIT'S DECISION IS AT ODDS WITH THE *COMMONWEALTH COATINGS* DISCLOSURE RULE, WHICH IS CRITICAL TO THE ARBITRATION SYSTEM'S CONTINUATION AS A VIABLE ALTERNATIVE TO LITIGATION.

In this Court's only decision in an arbitrator non-disclosure case, *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968), one of three arbitrators failed to disclose the fact that he had a professional relationship with one of the parties to the proceeding – information that any reasonable party selecting an arbitrator would want to have known. Although the party challenging the award never claimed that the withholding arbitrator "was actually guilty of fraud or bias in deciding th[e] case, and [this Court had] no reason, apart from the undisclosed business relationship to suspect him of any improper motives," *id.* at 147, it nevertheless held that the award must be vacated on the sole ground that the arbitrator failed to disclose "dealings that might create an impression of possible bias," *id.* at 149. "The Court has never changed that holding; it is the law that rules us today." (Pet. App. 16a.)

The Fifth Circuit's recent decision that "vacatur is only warranted upon nondisclosure that involves a significant compromising relationship" (Pet. App. 15a) "change[s] the law for this case" (Pet. App. 16a). By refusing to vacate an award unless the arbitrator was involved in a "compromising relationship," the Fifth Circuit disregarded this Court's decision that failure to disclose material information is sufficient to justify vacatur even when the arbitrator is indisputably "innocent of any actual partiality, or bias, or improper motive." *Commonwealth Coatings*, 393 U.S. at 152 (Fortas, J., dissenting). The Fifth Circuit, the dissenting judges admonished, "may not overrule a decision of the Supreme Court." (Pet. App. 16a.)

Although, as both the en banc majority and dissent noted, some courts have considered Justice White's concurrence controlling precedent and Justice Black's opinion a mere plurality (Pet. App. 8a, 20a & n.3), *neither* opinion supports the Fifth Circuit's decision that arbitral awards must be upheld "unless bias was clearly evident in the decisionmakers" (Pet. App. 5a). Whether Justice White actually "joined" Justice Black's "majority" opinion (as he said he did), 393 U.S. at 150 & 151 n.* (White, J., concurring), or whether that was only a "magnanimous" gesture on his part (as the Fifth Circuit would have it) (Pet. App. 7a), the fact remains that Justice White agreed to overturn the award while recognizing that the arbitrator before him "was entirely fair and impartial," *id.* at 151 n.* (White, J., concurring). The Fifth Circuit's opinion that only "significant compromising" relationships must be disclosed is irreconcilable with this Court's decision that parties selecting an arbitrator must be made privy to all relationships that "*might* create an impression of *possible* bias," *id.* at 149 (emphasis added) – in Justice White's words, all non-"trivial" relationships, *id.* at 152 (White, J., concurring) – so that they can decide for themselves whether any of them are "compromising" in nature.

This Court's reasonable impression of bias standard – which objectively assesses the sufficiency of information disclosed from the perspective of parties choosing an arbitrator – is critical because it recognizes what Judge Wiener identified as the "key differences between arbitration under the FAA and litigation in federal court." (Pet. App. 26a.) Parties agreeing to arbitration forfeit the protections afforded by formal rules of procedure and evidence; they sacrifice the right to meaningful appellate review. To offset those substantial risks and to balance the practically unlimited power that arbitrators wield over parties' claims, the parties are usually contractually provided "virtually absolute control over accepting or rejecting a nominee for the role of decision maker." (Pet. App. 31a.)

A meaningful choice, this Court decided nearly forty years ago, demands that parties selecting an arbitrator have access to all information that "*might* create an impression of *possible* bias." *Commonwealth Coatings*, 393 U.S. at 149 (emphasis added). Judge Wiener reiterated the importance of that broad disclosure rule when he stated that "[a]s gatekeepers, the parties are charged with guarding against favoritism and prejudice, a duty that they cannot possibly discharge in the absence of total disclosure." (Pet. App. 30a-31a.)

The Fifth Circuit's en banc decision turns *Commonwealth Coatings* on its head. Whereas Justice White insisted that arbitrators disclose all but "trivial" relationships with the parties and their counsel so that the parties themselves can be the "judge[s] of the arbitrator's impartiality," 393 U.S. at 150-52 (White, J., concurring), the Fifth Circuit now says that arbitrators need only disclose "a significant *compromising* connection to the parties" (Pet. App. 9a). In direct contravention of *Commonwealth Coatings*, the Fifth Circuit is letting the arbitrator vying for the job – rather than the parties to the proceeding – calculate the risk of possible bias and decide whether a given relationship would significantly compromise his ability to decide a case, thus warranting disclosure. In Judge Wiener's words, the en banc majority "left to the fox, who is the potential arbitrator, to guard the arbitration henhouse, secretly identifying to himself alone all 'prior or present relationships,' then just as secretly deciding which are worthy of disclosure and which are not." (Pet. App. 31a.)

If allowed to stand, the Fifth Circuit's decision will permit arbitrators to withhold information reasonably necessary to an informed selection – devastating parties' confidence in the arbitration system and eventually discouraging litigants from agreeing to arbitrate in the first place. Without the *Commonwealth Coatings* disclosure rule intact, parties will have no "faith in [the] objectivity" of the arbitrator ultimately chosen, reducing parties' "voluntary compliance with the decree, without need for judicial enforcement." *Commonwealth Coatings*, 393 U.S. at 151 (White, J. concurring). As Judge Wiener recognized in his dissent, *Commonwealth Coatings* is necessary "[f]or the system to enjoy credibility." (Pet. App. 32a.)

That threat to the viability of the arbitration system as a whole cannot be taken lightly. Arbitration is now "the favored method of dispute resolution" (Pet. App. 21a), and as this Court has recognized, "'[t]he advantages of arbitration are many'":

> "[I]t is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices. . . ."

Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265, 280 (1995) (quoting H.R. Rep. No. 97-542, p. 13 (1982)). This case calls into question not only the federal arbitration system, but also the dozens of parallel state systems that likewise authorize vacatur upon a finding of "evident partiality."[4] The Fifth Circuit's decision jeopardizing the integrity of the arbitrator selection process raises serious questions worthy of this Court's review.

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[4] Alaska (AS 09.43.500); Arizona (A.R.S. § 12-1512); Arkansas (A.C.A. § 16-108-212); Colorado (C.R.S.A. § 13-22-223); Connecticut (C.G.S.A. § 52-418); Delaware (10 Del. C. § 5714); Florida (F.S.A. § 682.13); Hawaii (HRS § 658A-23); Idaho (I.C. § 7-912); Illinois (710 ILCS 5/12); Indiana (IC 34-57-2-13); Iowa (I.C.A. § 679A.12); Kansas (K.S.A. § 5-412); Kentucky (KRS § 417.160); Louisiana (LSA-R.S. § 9:4210); Maine (14 M.R.S.A. § 5938); Maryland (MD Code § 3-224); Massachusetts (M.G.L.A. 251 § 12); Michigan (Mich. Rules Ct. 3.602); Minnesota (M.S.A. § 572.19); Mississippi (Miss. Code Ann. § 11-15-23); Missouri (V.A.M.S. 435.405); Montana (MCA 27-5-312); Nebraska (Neb.Rev.Stat. § 25-2613); Nevada (N.R.S. 38.241); New Jersey (N.J.S.A. 2A:23B-23); New Mexico (N.M.S.A. § 44-7A-24); North Carolina (N.C.G.S.A. § 1-569.23); North Dakota (NDCC 32-29.3-23); Ohio (R.C. § 2711.10); Oklahoma (12 Okl.St.Ann. § 1874); Oregon (O.R.S. § 36.705); Pennsylvania (42 Pa.C.S.A. § 7314); Rhode Island (R.I. Gen.Laws § 10-3-12); South Carolina (S.C. Code 1976 § 15-48-130); South Dakota (SDCL § 21-25A-24); Tennessee (T.C.A. § 29-5-313); Texas (V.T.C.A. § 171.088); Utah (U.C.A. § 78-31a-124); Vermont (12 V.S.A. § 5677); Virginia (Va. Code Ann. § 8.01-581.010); Washington (RCWA 7.04A.230); Wisconsin (W.S.A. 788.10); and Wyoming (W.S. § 1-36-114).

II. THE FIFTH CIRCUIT'S DECISION IS IN CONFLICT WITH THE DECISIONS OF OTHER CIRCUIT COURTS THAT ADHERE TO *COMMONWEALTH COATINGS.*

The Fifth Circuit's decision is at odds not only with *Commonwealth Coatings* but also with the various standards that lower courts have adopted in arbitrator non-disclosure cases. The confusion among many lower courts over the correct interpretation of *Commonwealth Coatings* has been extensively noted by courts, *see, e.g.*, *Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 51 F.3d 157, 159 (8th Cir. 1995) ("[T]here is some uncertainty among the courts of appeals about the holding of *Commonwealth Coatings.*"); *Kinn v. Alaska Sales & Service, Inc.*, 144 P.3d 474, 485 (Alaska 2006) (noting that "[f]ederal courts, and state courts interpreting [provisions similar to 9 U.S.C. § 10(a)(2)] have articulated different versions of th[e] standard, with some courts finding evident partiality when arbitrators fail to disclose relationships that would lead a reasonable person to believe that a conflict *actually* exists, and others finding evident partiality where the information not disclosed by the arbitrator would lead a reasonable person to believe that a conflict *could* exist") (citations omitted); *Burlington Northern R.R. Co. v. TUCO Inc.*, 960 S.W.2d 629, 633-34 (Tex. 1997) (observing that federal and state courts are "divided" over the correct interpretation of *Commonwealth Coatings*), and commentators alike, *see, e.g.*, Lee Korland, *What an Arbitrator Should Investigate and Disclose: Proposing a New Test for Evident Partiality Under the Federal Arbitration Act*, 53 Case W. Res. L. Rev. 815, 826 (2003) (observing that lower courts considering arbitrator non-disclosure claims have applied "various standards," which "suggest just how much courts have struggled in interpreting the *Commonwealth Coatings* decision"); James L. Knoll, *Disqualification of Arbitrators: What Does An Arbitrator Need to*

Disclose?, 32-WTR Brief 12, 14 (2003) ("In construing *Commonwealth Coatings*, courts, both federal and state, have run the gamut from requiring full disclosure of essentially all business relationships to requiring no more than disclosure of certain intimate business relationships."); Jennifer C. Bailey, *The Search to Clarify an Elusive Standard: What Relationships Between Arbitrator and Party Demonstrate Evident Partiality?*, 2000 J. Disp. Resol. 153, 153 (2000) (noting that courts' reliance on *Commonwealth Coatings* "has proved problematic, and led to both federal and state courts adopting inconsistent standards of evident partiality"); Elizabeth A. Murphy, *Standards of Arbitrator Impartiality: How Impartial Must They Be?*, 1996 J. Disp. Resol. 463, 470 (1996) ("[F]ederal courts have floundered in the wake of [*Commonwealth Coatings*]."). Even the dissenting judges in this case observed that "the *Commonwealth Coatings* ruling has not been well received by some of the circuit courts." (Pet. App. 18a; *see also* Pet. App. 20a (noting that *Commonwealth Coatings* has been met with "judicial disfavor").)

The Fifth Circuit, however, was the first to adopt the rule that "[a]n arbitrator's failure to disclose must involve a significant compromising connection to the parties" (Pet. App. 9a), and its decision stands in direct conflict with the Ninth Circuit's decision in *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994). Whereas the en banc majority evaluated whether the undisclosed relationship evidences *actual* bias, the Ninth Circuit's test – faithful to *Commonwealth Coatings* – measures whether the undisclosed facts suggest the *potential* for bias on the arbitrator's part:

> Finding a "reasonable impression" of partiality is not equivalent to, nor does it imply, a finding of actual bias. Otherwise, the *Commonwealth Coatings* court could not have held that a reasonable impression of partiality was present when no actual bias was shown.

Id. at 1047. The Ninth Circuit underscored that the parties can only "choose their arbitrators intelligently" and calculate the risk of actual bias for themselves when arbitrators disclose all "facts showing *potential* partiality" – not only "significant *compromising*" relationships (Pet. App. 15a (emphasis added)):

> Showing a "reasonable impression of partiality" is sufficient in a nondisclosure case because the policy of section 10(a)(2) instructs that the parties should choose their arbitrators intelligently. *The parties can choose their arbitrators intelligently only when facts showing potential partiality are disclosed.*

Schmitz, 20 F.3d at 1047 (emphasis added) (citing *Commonwealth Coatings*, 393 U.S. at 151 (White, J., concurring)).

Although the Fifth Circuit characterized the *Schmitz* decision as an "outlier" (Pet. App. 10a), other appellate courts have likewise approached the issue of arbitrator non-disclosure from a party perspective. In *Sanko S.S. Co., Ltd. v. Cook Industries, Inc.*, 495 F.2d 1260 (2d Cir. 1973), the Second Circuit held that an award must be vacated when an arbitrator fails to disclose ties that might "reasonably create an impression of bias" in a party's mind. *Id.* at 1264 n.3. In fact, the Second Circuit went so far as to counsel arbitrators to disclose *all* relationships with the parties or attorneys before them, however trivial:

> Indeed, it seems to us that *the better practice is that arbitrators should disclose fully all their relationships with the parties, whether these ties be of a direct or indirect nature.* Although some unnecessary disclosure may result, if arbitrators err on the side of disclosure, . . . it will not be difficult for courts to identify those undisclosed relationships which are too insubstantial to warrant vacating an award.

Id. at 1263-64 (emphasis added) (citing *Commonwealth Coatings*, 393 U.S. at 152 (White, J., concurring));[5] *Burlington*, 960 S.W.2d at 635 (following *Schmitz* in holding: "[A] prospective neutral arbitrator selected by the parties or their representatives exhibits evident partiality if he or she does not disclose facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality. We emphasize that this evident partiality is established from the *nondisclosure itself*, regardless of whether the nondisclosed information necessarily establishes partiality or bias.").

Some circuits are internally inconsistent, adopting *both* a "reasonable impression of bias" *and* an "actual bias" standard. The Eleventh Circuit, for example, in *University Commons-Urbana, Ltd. v. Universal Constructors Inc.*, 304 F.3d 1331 (11th Cir. 2002), applied a "stringent[ ]" disclosure rule and highlighted the importance of revealing all information that "might create an impression of possible bias" in the eyes of the parties. *Id.* at 1339. But in an earlier decision, *Lifecare International, Inc. v. CD Medical, Inc.*, 68 F.3d 429 (11th Cir. 1995), while still subscribing to the "reasonable impression of bias" test and the Ninth Circuit's opinion in *Schmitz v. Zilveti*, the Eleventh Circuit remarked that "'the alleged partiality must be direct, definite and capable of demonstration.'" *Id.* at 433 (citations omitted).

A number of other circuits contradict themselves within the confines of a single decision. In *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673 (7th Cir. 1983), for example, in the context of a Rule 60(b) challenge, the Seventh Circuit endorsed an "appearance of bias" standard, *id.* at 682, while suggesting elsewhere in its opinion that the correct test is whether the undisclosed relationship "was so intimate – personally, socially, professionally, or financially – as to cast serious doubt on [the arbitrator's] impartiality," *id.* at 680. Similarly, in *Ormsbee Dev. Co. v. Grace*, 668 F.2d 1140 (10th Cir. 1982), the Tenth Circuit approved the district court's ruling that "failure to disclose non-trivial relationships with parties will be grounds for vacating an arbitration award regardless of any actual bias, prejudice, unfairness or lack of the same in the hearing," *id.* at 1150, but added that vacatur requires "clear evidence of impropriety," *id.* at 1147; *see also Al-Harbi v. Citibank, N.A.*, 85 F.3d 680, 683 (D.C. Cir. 1996) (noting that an arbitrator has the duty to disclose all facts "that might create an impression of possible bias," but that the party challenging the award on non-disclosure grounds "must establish specific facts that indicate improper motives on the part of an arbitrator") (citation omitted).

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[5] Although a subsequent Second Circuit case, *Morelite Constr. Corp. v. New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79 (2d Cir. 1984) in dicta observed that Justice Black wrote for a plurality in *Commonwealth Coatings*, *id.* at 82, *Morelite* did not involve an arbitrator's failure to disclose and thus has no bearing on the standard adopted in *Sanko*.

To resolve the split created by the Fifth Circuit's decision and the general confusion among the lower courts over the correct interpretation of *Commonwealth Coatings* and the proper standard in non-disclosure cases, this Court should grant Positive Software's petition. Indeed, the facts of this case are particularly well-suited for review. Whereas in *Schmitz*, the undisclosed relationship between the arbitrator's law firm and the parent company of one of the parties was decidedly *in*direct, 20 F.3d at 1044; *see also Olson*, 51 F.3d at 159 (setting aside an award despite the fact that the arbitrator was "not personally involved" in the undisclosed business relationship between his employer and one of the parties to the arbitration), here the undisclosed relationship *personally* involved Peter Shurn and New Century's co-lead arbitration counsel, Ophelia Camiña. In fact, the collaboration between Shurn and Camiña was so personal and direct that the district court did not even think discovery was necessary to ascertain the full extent of the relationship – the existing evidence was more than adequate to satisfy the *Commonwealth Coatings* standard. (Pet. App. 99a-100a.)[6]

This case also lends itself to review because Shurn's non-disclosure indisputably prejudiced Positive Software's selection. Left in the dark, Positive Software ranked Shurn first on its final list of acceptable arbitrators. (1PSSApp164.) The district court easily found that "[h]ad Positive Software been aware of the Arbitrator's prior relationship with New Century's co-counsel and with SG Law Firm, co-counsel's law firm, Positive Software would not have ranked the Arbitrator so highly, and he would not have become the arbitrator in this matter. (Pet. App. 86a.) In *Commonwealth Coatings* and *Merit Ins. Co. v. Leatherby Ins. Co.*, by contrast, the non-disclosure was harmless because the same arbitrator likely would have been selected even if all potential conflicts had been disclosed in advance. 393 U.S. at 153 (Fortas, J., dissenting); 714 F.2d at 683.

Finally, this case is certworthy because – as the district court found – the potential impact of Shurn's non-disclosure was heightened by the fact that he alone decided the case. (Pet. App. 99a.) Several cases cited by the en banc majority (Pet. App. 11a-12a), including *Merit Ins.*

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[6] Although the en banc majority, as Judge Reavley pointed out, "bleach[ed] the evidence of possible partiality" and "reduc[ed] the record to Camiña's statement that she did no work with Shurn" (Pet. App. 21a, 25a), this case compels review even under the majority's whitewashed version of the facts. The en banc majority, after all, acknowledged that Shurn and Camiña had "represented Intel in protracted patent litigation that lasted from 1990 to 1996," and that they "each signed the same ten pleadings." (Pet. App. 11a.)

Co. v. Leatherby Ins. Co., *Montez v. Prudential Sec., Inc.*, 260 F.3d 980 (8th Cir. 2001), and of course *Commonwealth Coatings*, involved three-arbitrator panels whose decisions were unanimous. Obviously, a botched selection process is far more likely to affect the outcome of the case in arbitrations involving a single decisionmaker. *Cf. Merit*, 714 F.2d at 683 (because even the non-neutral arbitrator appointed by the party challenging the award "did not regard this as a close case," "rerunning the arbitration before a different panel is unlikely to change the outcome"). The compelling circumstances of this case warrant this Court's review.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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476 F.3d 278

United States Court of Appeals, Fifth Circuit.

POSITIVE SOFTWARE SOLUTIONS, INC.,
Plaintiff-Appellee,
v.
NEW CENTURY MORTGAGE CORPORATION;
New Century Financial Corporation; eConduit Corporation;
The Anyloan Company; Jeff Lemieux; Frank Nese,
Defendants-Appellants.
No. 04-11432.

Jan. 18, 2007.

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Appeal from the United States District Court for the Northern District Texas.

Before JONES, Chief Judge, and REAVLEY, JOLLY, HIGGINBOTHAM, DAVIS, SMITH, WIENER, BARKSDALE, GARZA, DeMOSS, BENAVIDES, STEWART, DENNIS, CLEMENT, PRADO and OWEN, Circuit Judges.*

EDITH H. JONES, Chief Judge, joined by E. GRADY JOLLY, PATRICK E. HIGGINBOTHAM, W. EUGENE DAVIS, JERRY E. SMITH, RHESA H. BARKSDALE,

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* Circuit Judge KING did not participate in the decision.

DeMOSS, DENNIS, EDITH BROWN CLEMENT, PRADO and OWEN, Circuit Judges:

The court reconsidered this case en banc in order to determine whether an arbitration award must be vacated for "evident partiality," 9 U.S.C. § 10(a)(2), where an arbitrator failed to disclose a prior professional association with a member of one of the law firms that engaged him. We conclude that the Federal Arbitration Act ("FAA") does not mandate the extreme remedy of vacatur for nondisclosure of a trivial past association, and we reverse the district court's contrary judgment, but it is necessary to remand for consideration of appellee's other objections to the arbitral award.

BACKGROUND

The facts are undisputed. In January 2001, New Century Mortgage Corporation ("New Century") licensed an automated software support program from Positive Software Solutions, Inc. ("Positive Software"). In December 2002, during negotiations for a renewal of that license, Positive Software alleged that New Century copied the program in violation of the parties' agreement and applicable copyright law. Positive Software then filed this lawsuit against New Century in the Northern District of Texas alleging breach of contract, misappropriation of trade secrets, misappropriation of intellectual property, copyright infringement, fraud, and other causes of action. Positive Software sought specific performance, money damages, and injunctive relief.

In April 2003, the district court granted Positive Software's motion to preliminarily enjoin New Century from using the program and, pursuant to the parties' contract, submitted the matter to arbitration. Following American Arbitration Association ("AAA") procedures, the AAA provided the parties with a list of potential arbitrators and asked the parties to rank the candidates. After reviewing biographical information, the parties selected Peter Shurn to arbitrate the case, as he had the highest combined ranking. The AAA contacted Shurn about serving as an arbitrator, and he agreed, after stating that he had nothing to disclose regarding past relationships with either party or their counsel.

After a seven-day hearing, Shurn issued an eighty-six page written ruling, concluding that New Century did not infringe Positive Software's copyrights, did not misappropriate trade secrets, did not breach the contract, and did not defraud or conspire against Positive Software. He ordered that Positive Software take nothing on its claims and granted New Century $11,500 on its counterclaims and $1.5 million in attorney's fees.

Upon losing the arbitration, Positive Software conducted a detailed investigation of Shurn's background. It discovered that several years earlier, Shurn and his former law firm, Arnold, White, & Durkee ("Arnold White"), had represented the same party as New Century's counsel, Susman Godfrey, L.L.P., in a patent litigation between Intel Corporation and Cyrix Corporation ("the Intel litigation"). One of Susman Godfrey's attorneys in the New Century arbitration, Ophelia Camiña, had been involved in the Intel litigation.

The Intel litigation involved six different lawsuits in the early 1990s. Intel was represented by seven law firms and at least thirty-four lawyers, including Shurn and Camiña. The dispute involved none of the parties to the arbitration. Camiña participated in representing Intel in three of the lawsuits from August 1991 until July 1992, although her name remained on the pleadings in one of the cases until June 1993. In September 1992, Shurn, along with twelve other Arnold White attorneys, entered an appearance in two of the three cases on which Camiña worked. Although their names appeared together on pleadings, Shurn and Camiña never attended or participated in any meetings, telephone calls, hearings, depositions, or trials together.

Positive Software filed a motion to vacate the arbitration award, alleging that the award had been procured by fraud, Shurn had manifestly disregarded applicable laws, and, despite the lack of contact between Shurn and Camiña, Shurn had been biased, as evidenced by his failure to disclose his past connection to Camiña. In September 2004, the district court granted Positive Software's motion and vacated the award, finding that Shurn failed to disclose "a significant prior relationship with New Century's counsel," thus creating an appearance of partiality requiring vacatur. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.,* 337 F.Supp.2d 862, 865 (N.D.Tex.2004). New Century appealed, and a panel of this court affirmed the district court's vacatur on the ground that the prior relationship "might have conveyed an impression of possible partiality to a reasonable person." *Positive Software Solutions, Inc. v. New Century Mortgage Corp.,* 436 F.3d 495, 504 (5th Cir.2006). Neither the district court nor the appellate panel found that Shurn was actually biased toward New Century. This court granted New Century's petition for rehearing en banc.

DISCUSSION

To assure that arbitration serves as an efficient and cost-effective alternative to litigation, and to hold parties to their agreements to arbitrate, the FAA narrowly restricts judicial review of arbitrators' awards. The ground of vacatur alleged here is that "there was evident partiality" in the arbitrator.[1] The meaning of evident partiality is discernible definitionally and as construed by the Supreme Court and a number of our sister circuits.

On its face, "evident partiality" conveys a stern standard. Partiality means bias, while "evident" is defined as "clear to the vision or understanding" and is synonymous with manifest, obvious, and apparent. *Webster's Ninth New Collegiate Dictionary* 430 (1985). The statutory language, with which we always begin, seems to require upholding arbitral awards unless bias was clearly evident in the decisionmakers.

The panel decision here disagreed with the straightforward interpretation, however, and concluded that, in "a nondisclosure case in which the parties chose the arbitrator," the "arbitrator selected by the parties displays evident partiality by the very failure to disclose facts that might create a reasonable impression of the arbitrator's partiality." 436 F.3d at 502. The panel acknowledged a lack of any actual bias in this award even as it substituted a reasonable impression of partiality standard for "evident" partiality in cases of an arbitrator's nondisclosure to the parties. The panel believed this different standard to be required by the Supreme Court's decision in *Commonwealth Coatings Corp. v. Continental Cas. Co.,* 393 U.S. 145, 89 S.Ct. 337, 21 L.Ed.2d 301 (1968), which interpreted § 10(b).[2]

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[1] 9 U.S.C. § 10(a)(2) ("[T]he United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration . . . where there was evident partiality or corruption in the arbitrators . . . .").

How *Commonwealth Coatings* guides this court is a critical issue. Reasonable minds can agree that *Commonwealth Coatings,* like many plurality-plus Supreme Court decisions, is not pellucid. Justice Black delivered the opinion of the Court and imposed "the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias." *Id.* at 149, 89 S.Ct. at 339. He noted that, while arbitrators are not expected to sever all ties with the business world, courts must be scrupulous in safeguarding the impartiality of arbitrators, who are given the ability to decide both the facts and the law and whose decisions are not subject to appellate review. *Id.* at 148-49, 89 S.Ct. at 339. Thus, arbitrators "not only must be unbiased but also must avoid even the appearance of bias," *Id.* at 150, 89 S.Ct. at 340, in order to maintain confidence in the arbitration system.

Justice White, the fifth vote in the case, together with Justice Marshall, purported to be "glad to join" Justice Black's opinion, but he wrote to make "additional remarks." *Id.* (White, J., concurring). Justice White emphasized that "[t]he Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed of any judges." *Id.* Indeed, Justice White wrote that arbitrators are not "automatically disqualified by a business relationship with the parties before them if . . . [the parties] are unaware of the facts but the relationship is trivial." *Id.* While supporting a policy of disclosure by arbitrators to enhance the selection process, Justice White also concluded, in a practical vein, that an arbitrator "cannot be expected to provide the parties with his complete and unexpurgated business biography." *Id.* at 151, 89 S.Ct. at 340. His opinion fully envisions upholding awards when arbitrators fail to disclose insubstantial relationships. *Id.* at 152, 89 S.Ct. at 341.

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[2] What was then § 10(b) is now contained in § 10(a)(2).

If one lays primary emphasis on Justice White's statement that he was "glad to join" the plurality, his opinion can be deemed reconcilable with that of Justice Black. Only in that event is the plurality opinion binding on lower courts.

Another compelling reading of the opinions is also possible, however. Justice Black's opinion uses an egregious set of facts as the vehicle to require broad disclosure of "any dealings that might create an impression of possible bias." *Id.* at 149, 89 S.Ct. at 339. Justice White, for his part, hews closely to the facts and finds it "enough for present purposes to hold, as the Court does, that where the arbitrator has a *substantial interest* in a firm which has done *more than trivial business* with a party, that fact must be disclosed." 393 U.S. at 151-52, 89 S.Ct. at 340-41 (emphasis added). Justice White, thus read, supports ample but not unrealistic disclosure, and he supports a cautious approach to vacatur for nondisclosure. His "joinder" is magnanimous but significantly qualified.

The latter reading is more persuasive, because it accords scope to the full White opinion, unlike the view that focuses on the introductory "glad to join" sentence.

Thus, Justice White's concurrence, pivotal to the judgment, is based on a narrower ground than Justice Black's opinion, and it becomes the Court's effective ratio decidendi. *See Marks v. United States,* 430 U.S. 188, 193-94, 97 S.Ct. 990, 993-94, 51 L.Ed.2d 260 (1977).

A majority of circuit courts have concluded that Justice White's opinion did not lend majority status to the plurality opinion. *See Nationwide Mut. Ins. Co. v. Home Ins. Co.,* 429 F.3d 640, 644 n. 5 (6th Cir.2005) ("[A] majority of the Court did not endorse the 'appearance of bias' standard set forth in the plurality opinion"); *ANR Coal Co., Inc. v. Cogentrix of N.C., Inc.,* 173 F.3d 493, 499-500 & n. 3 (4th Cir.1999) (noting that courts have given Justice White's "concurrence particular weight" and holding that "an arbitrator's failure to reveal facts may be relevant in determining evident partiality under 9 U.S.C. § 10(a)(2), but that mere nondisclosure does not in itself justify vacatur"); *Morelite Constr. Corp. v. N.Y. City Dist. Council Carpenters Benefit Funds,* 748 F.2d 79, 83 n. 3 (2d Cir.1984) ("Because the two opinions are impossible to reconcile, however, we must narrow the holding to that subscribed to by both Justices White and Black"); *Merit Ins. Co. v. Leatherby Ins. Co.,* 714 F.2d 673, 681 (7th Cir.1983) (noting that *Commonwealth Coatings* "provides little guidance because of the inability of a majority of Justices to agree on anything but the result"); *cf. Univ. Commons-Urbana, Ltd. v. Universal Constructors Inc.,* 304 F.3d 1331, 1339-40 (11th Cir.2002) (citing Justice White's *Commonwealth Coatings* opinion and permitting vacatur only if facts creating "a reasonable impression of partiality" are not disclosed); *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.,* 991 F.2d 141, 146 (4th Cir.1993) ("It is well established that a mere appearance of bias is insufficient to demonstrate evident partiality. Arbitrators are not held to the same ethical standards required of Article III judges. . . ." (citations omitted)); *Ormsbee Dev. Co. v. Grace,* 668 F.2d 1140, 1147, 1150-51 (10th Cir.1982) (citing Justice White's *Commonwealth Coatings* opinion and requiring "clear evidence of impropriety" for vacatur). While these courts' interpretations of *Commonwealth Coatings* may differ in particulars, they all agree that nondisclosure alone does not require vacatur of an arbitral award for evident partiality. An arbitrator's failure to disclose must involve a significant compromising connection to the parties.

This court's prior caselaw is also consistent with a narrow reading of *Commonwealth Coatings.* In *Bernstein Seawell & Kove v. Bosarge,* 813 F.2d 726 (5th Cir.1987), the losing party in the arbitration challenged the award because of the alleged evident partiality of one of the arbitrators. The arbitrator owned a fractional share of the disputed property and had received commissions on the sale of certain interests. The court held the party had waived his objection to the composition of the panel. Nevertheless, "[e]ven assuming no waiver," he had not produced evidence of evident partiality,[3] because "[t]he appearance of impropriety, standing alone, is insufficient." *Id.* at 732 (quoting *Sheet Metal Workers Int'l Ass'n Local Union 420 v. Kinney Air Conditioning Co.,* 756 F.2d 742, 746 (9th Cir.1985)). The court also noted that "[e]vident partiality means more than a mere appearance of bias."

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[3] The discussion surrounding the court's finding of no evidence of evident partiality is an alternative holding, not dicta, and accordingly, its discussion of evident partiality is binding precedent on any subsequent panels.

Id. (quoting *Florasynth, Inc. v. Pickholz,* 750 F.2d 171, 173 (2d Cir.1984)).

Only the Ninth Circuit has interpreted *Commonwealth Coatings,* as the panel majority did, to deemphasize Justice White's narrowing language. *See Schmitz v. Zilveti,* 20 F.3d 1043 (9th Cir.1994). In *Schmitz,* the court criticized case law suggesting "that an impression of bias is sufficient while an appearance [of bias] is not." *Id.* at 1047. *Commonwealth Coatings,* it held, does not merit such a "hairline distinction." *Id. Schmitz* not only interpreted *Commonwealth Coatings* to mandate a "reasonable impression of bias" standard in nondisclosure cases but went on to vacate an arbitral award where the arbitrator had not himself been aware of the potential conflict and had failed to undertake due diligence to ascertain and then disclose it to the parties.[4] Even if one ignores the extension of *Commonwealth Coatings* by *Schmitz,* the undisclosed relationship between the arbitrator's firm and Pru-Bache's parent company was more current, concrete and financially meaningful than the co-counsel relationship in the present case. *Schmitz* is an outlier that lends little support to Positive Software.

As we have concluded, the better interpretation of *Commonwealth Coatings* is that which reads Justice White's opinion holistically. The resulting standard is that in nondisclosure cases, an award may not be vacated because of a trivial or insubstantial prior relationship between the arbitrator and the parties to the proceeding. The "reasonable impression of bias" standard is thus interpreted practically rather than with utmost rigor.

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[4] In *Schmitz,* the arbitrator's law firm previously had represented Prudential Insurance Co., the parent of Pru-Bache Securities, the prevailing party in the arbitration. The representation involved at least nineteen cases over a thirty-five year period, including a case that ended less than two years before the arbitration. The arbitrator had reviewed documents naming the parent company, but did not run a conflict check for the parent or disclose any of his firm's earlier representations of the parent company prior to the arbitration.

According to this interpretation of *Commonwealth Coatings,* the outcome of this case is clear: Shurn's failure to disclose a trivial former business relationship does not require vacatur of the award. The essential charge of bias is that the arbitrator, Peter Shurn, worked on the same litigation as did Ophelia Camiña, counsel for one of the parties. They represented Intel in protracted patent litigation that lasted from 1990 to 1996. Camiña and Shurn each signed the same ten pleadings, but they never met or spoke to each other before the arbitration. They were two of thirty-four lawyers, and from two of seven firms, that represented Intel during the lawsuit, which ended at least seven years before the instant arbitration.

No case we have discovered in research or briefs has come close to vacating an arbitration award for nondisclosure of such a slender connection between the arbitrator and a party's counsel. In fact, courts have refused vacatur where the undisclosed connections are much stronger. *See, e.g., Montez v. Prudential Sec., Inc.,* 260 F.3d 980, 982, 984 (8th Cir.2001) (no vacatur; as general counsel for a company, arbitrator had employed sixty-eight attorneys, paying them $2.8 million in fees, from the law firm representing one of the parties in the arbitration); *ANR Coal,* 173 F.3d at 495-96 (no vacatur; arbitrator's law firm represented company that indirectly caused the dispute in the arbitration by buying less from the defendant, who in turn sought to buy less from the plaintiff); *Al-Harbi v. Citibank, N.A.,* 85 F.3d 680, 682 (D.C.Cir.1996) (no vacatur where arbitrator's former law firm represented party to the arbitration on unrelated matters); *Lifecare Int'l, Inc. v. CD Med., Inc.,* 68 F.3d 429, 432-34 & n. 3 (11th Cir.1995) (no vacatur where arbitrator had memorialized prior scheduling dispute with an attorney from the law firm representing one of the parties and mentioned it eighteen months later at the arbitration; arbitrator also failed to disclose that he became "of counsel" to a law firm the prevailing party had interviewed for the purpose of obtaining representation in the instant dispute and that had reviewed the contract involved in the case two years prior; court found this, at best, showed a "remote, uncertain, and speculative partiality"); *Health Servs. Mgmt. Corp. v. Hughes,* 975 F.2d 1253, 1255, 1264 (7th Cir.1992) (arbitrator knew one of the parties, had worked in the same office with him twenty years ago, and saw him about once a year since; the court found this relationship "minimal" and insufficient to vacate); *Merit Ins.,* 714 F.2d at 677, 680 (no vacatur; arbitrator had worked directly under the president and principal stockholder of one of the parties for three years, ending fourteen years prior to the arbitration; the Seventh Circuit noted that "[t]ime cools emotions, whether of gratitude or resentment"); *Ormsbee Dev. Co.,* 668 F.2d at 1149-50 (no vacatur where arbitrator and law firm representing a party had clients in common; requiring vacatur under such facts would "request that potential neutral arbitrators sever all their ties with the business world" (internal quotation omitted)).

The relationship in this case pales in comparison to those in which courts have granted vacatur. *See, e.g., Commonwealth Coatings,* 393 U.S. at 146, 89 S.Ct. at 338 (business relationship between arbitrator and party was "repeated and significant"; the party to the arbitration was one of the arbitrator's "regular customers"; "the relationship even went so far as to include the rendering of services on the very projects involved in this lawsuit"); *Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 51 F.3d 157, 159 (8th Cir.1995) (arbitrator was a high-ranking officer in a company that had a substantial ongoing business relationship with one of the parties); *Schmitz,* 20 F.3d at 1044 (arbitrator's law firm represented parent company of a party for decades, including within two years of the arbitration); *Morelite,* 748 F.2d at 81 (arbitrator's father was General President of the union involved in the arbitrated dispute).

Finally, even if Justice White's "joinder" is not read as a limitation on Justice Black's opinion in *Commonwealth Coatings,* and the controlling opinion emphatically requires arbitrators to "disclose to the parties any dealings that might create an impression of possible bias," 393 U.S. at 149, 89 S.Ct. at 339, we cannot find the standard breached in this case. The facts of *Commonwealth Coatings* are easily distinguishable. In *Commonwealth Coatings,* the arbitrator and a party had a "repeated and significant" business relationship. *Id.* at 146, 89 S.Ct. at 338. The relationship involved fees of about $12,000 paid to the arbitrator by the party, extended over a period of four or five years, ended only one year before the arbitration, and even included the rendering of services on the very projects involved in the arbitration before him. *Id.* Such a relationship bears little resemblance to the tangential, limited, and stale contacts between Shurn and Camiña. Nothing in *Commonwealth Coatings* requires vacatur for the undisclosed relationship in this case.

CONCLUSION

Awarding vacatur in situations such as this would seriously jeopardize the finality of arbitration. Just as happened here, losing parties would have an incentive to conduct intensive, after-the-fact investigations to discover the most trivial of relationships, most of which they likely would not have objected to if disclosure had been made. Expensive satellite litigation over nondisclosure of an arbitrator's "complete and unexpurgated business biography" will proliferate. Ironically, the "mere appearance" standard would make it easier for a losing party to challenge an arbitration award for nondisclosure than for actual bias.

Moreover, requiring vacatur based on a mere appearance of bias for nondisclosure would hold arbitrators to a higher ethical standard than federal Article III judges. In his concurrence, Justice White noted that the Court did not decide whether "arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed of any judges." *Id.* at 150, 89 S.Ct. at 340 (White, J., concurring). This cannot mean that arbitrators are held to a *higher* standard than Article III judges. Had this same relationship occurred between an Article III judge and the same lawyer, neither disclosure nor disqualification would have been forced or even suggested. *See Chitimacha Tribe of La. v. Harry L. Laws Co.,* 690 F.2d 1157, 1166 (5th Cir.1982) (rejecting a finding of judicial bias where the federal judge had represented a party to the case in an unrelated matter at least six years prior). While it is true that disclosure of prior significant contacts and business dealings between a prospective arbitrator and the parties furthers informed selection,[5] it is not true, as Justice White's opinion perceptively explains, that "the best informed and most capable potential arbitrators" should be automatically disqualified (and their awards nullified) by failure to inform the parties of trivial relationships. *Commonwealth Coatings,* 393 U.S. at 150, 89 S.Ct. at 340.

Finally, requiring vacatur on these attenuated facts would rob arbitration of one of its most attractive features apart from speed and finality – expertise. Arbitration would lose the benefit of specialized knowledge, because the best lawyers and professionals, who normally have the longest lists of potential connections to disclose, have no need to risk blemishes on their reputations from post-arbitration lawsuits attacking them as biased.

Neither the FAA nor the Supreme Court, nor predominant case law, nor sound policy countenances vacatur of FAA arbitral awards for nondisclosure by an arbitrator unless it creates a concrete, not speculative impression of bias. Arbitration may have flaws, but this is not one of them. The draconian remedy of vacatur is only warranted upon nondisclosure that involves a significant compromising relationship. This case does not come close to meeting this standard.

The judgment of the district court is REVERSED, and the case is REMANDED FOR FURTHER PROCEEDINGS.

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[6] The American Arbitration Association ("AAA"), whose rules governed this proceeding, requires broad prophylactic disclosure of "any circumstance likely to affect impartiality or create an appearance of partiality," so that parties may rely on the integrity of the selection process for arbitrators. Whether Shurn's nondisclosure ran afoul of the AAA rules, however, is not before us and plays no role in applying the federal standard embodied in the FAA.

REAVLEY, Circuit Judge, dissenting, joined by WIENER, EMILIO M. GARZA, BENAVIDES and CARL E. STEWART, Circuit Judges:

In 1968 the Supreme Court held that an arbitral award could not stand where the arbitrator had failed to disclose a past relationship that might give the impression of possible partiality.[1] The Court has never changed that holding; it is the law that rules us today. But the majority of this court disapprove of that law because they prefer to protect arbitrators and their awards when they fail to disclose prior relationships with parties or counsel. They therefore change the law for this case and, to make it appear as if their transgression does not matter, trivialize their report of the past relationship. I dissent because this court may not overrule a decision of the Supreme Court.

Commonwealth Coatings

A.C. Samford Overseas, Inc. was the general contractor on six large construction projects in Puerto Rico. Commonwealth Coatings Corporation had the painting subcontract for the projects. A dispute arose about Commonwealth's performance and then its abandonment of the work. The dispute went to three arbitrators, and the unanimous award of all three awarded Samford $15,872.35. Commonwealth appealed to the First Circuit on the sole ground of the failure of Capacete, the impartial arbitrator selected by the other two arbitrators, and of appellee Samford, the successful party, to disclose their past relationship. Capacete was a majority owner of an engineering company that had done work for Samford, including work with the architects planning the projects at issue. He had done no work on the construction or any matter related to questions in the arbitration. When Capacete was being selected to be the third arbitrator, he was not asked about a prior relationship with Samford. The circuit court affirmed the denial of the attack on the award in the absence of bias or prejudice.[2]

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[1] *Commonwealth Coatings Corp. v. Cont'l Cas. Co.,* 393 U.S. 145, 89 S.Ct. 337, 21 L.Ed.2d 301 (1968).

The Supreme Court granted certiorari and vacated the arbitral award, saying that while the arbitrator had shown no improper motives, he was required to "disclose to the parties any dealings that might create an impression of possible bias." *Id.* at 147-49, 89 S.Ct. 337. The majority opinion was written by Justice Black. Justice White also wrote and began by saying: "While I am glad to join my Brother Black's opinion in this case, I desire to make these additional remarks." Six justices vacated the award even though the arbitrator had been fair and impartial.

The *Commonwealth Coatings* opinions of Justice Black (with Warren, Douglas, and Brennan joining) and Justice White (with Marshall joining) are not lengthy. They are easily compared and easily reconciled. Both opinions emphasize the importance of impartiality for those who decide controversy. Justice White distinguishes the role of judges from that of arbitrators in that the arbitrator's relation with a party is immaterial – so long as the other party is informed in advance and makes no objection. And he points out that a trivial relation would not create an impression of possible bias so as to meet the rule stated by Justice Black. Justice White's contribution emphasizes the importance of establishing an atmosphere of frankness at the outset of an arbitration by disclosure when the parties are free to reject the arbitrator or accept him with knowledge of the relationship. I am confident that Justices White and Marshall knew what they were saying when they said they joined Justice Black's opinion, and were not describing it as the majority opinion only to be "magnanimous" as our court now says. Furthermore, it is quite pellucid that six Justices of the Court agreed that, despite the fairness and impartiality of the arbitrator, failure to disclose "any dealings that might create an impression of possible bias" justifies vacatur of the award. The Court did vacate that award only for that reason.

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[2] *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 382 F.2d 1010 (1st Cir.1967).

Commonwealth Coatings and the Circuit Courts

The majority opinion manages to substitute actual bias, or the reasonable impression of bias, or concrete impression of bias for the Supreme Court's ruling that dealings that might create only an impression of possible bias must be disclosed. And it purports to join other circuits to hold that non-disclosure alone does not require vacatur of an arbitral award. If the circuit courts could overrule the Supreme Court, the majority might be on a bit firmer ground, because the *Commonwealth Coatings* ruling has not been well received by some of the circuit courts.

For example, Judge Posner declared in 1983 in *Merit Insurance Co. v. Leatherby Insurance Co.,* 714 F.2d 673, 680 (7th Cir.), that the test of the undisclosed relationship must be so intimate as to cast serious doubt on the arbitrator's impartiality. Even though the attack on the arbitral award there was under Rule 60(b) and was rejected because the award did not create a substantial danger of an unjust result, Judge Posner took the occasion to say that *Commonwealth Coatings* "provides little guidance because of the inability of a majority of Justices to agree on anything but the result." *Id.* at 681. The following year the Second Circuit had a case where the relationship was of father to son, known from the outset, but Judge Kaufman addressed *Commonwealth Coatings* as though the opinions of Justice Black and Justice White could not be reconciled and as though they had addressed disqualification of arbitrators rather than failure to disclose. *Morelite Constr. Corp. v. New York City Dist. Council Carpenters Benefit Funds,* 748 F.2d 79, 82-83 & n. 3 (1984). Judge Kaufman saw a problem with Justice Black's statement that arbitrators must avoid the appearance of bias. *Id.* at 82-83. All will agree with Justice Black's statement that any tribunal trying controversies must avoid bias and ~~the~~ appearance of bias, 393 U.S. at 150, 89 S.Ct. at 340, but this was not a statement of the disclosure requirement of the Court. Other courts have transposed the Supreme Court's disclosure requirement to avoid the "appearance of bias." *See, e.g., Sunkist Soft Drinks v. Sunkist Growers,* 10 F.3d 753, 758 (11th Cir.1993); *Apperson v. Fleet Carrier Corp.,* 879 F.2d 1344, 1358 n. 19 (6th Cir.1989); *Middlesex Mutual Ins. Co. v. Levine,* 675 F.2d 1197, 1200 (11th Cir.1982).

We should distinguish the *Commonwealth Coatings* requirement for disclosure of prior relationships when arbitrators are being selected from what will disqualify an arbitrator after selection. The majority misses that distinction in its discussion of *Bernstein Seawell & Kove v. Bosarge,* 813 F.2d 726 (5th Cir.1987).

The majority departs from the Supreme Court's ruling by following those courts that have decided that *Commonwealth Coatings* is a plurality or a "plurality-plus" opinion.[3] But the majority opinion, like the opinions on which it relies, do not explain how Justice Black's majority opinion is irreconcilable with Justice White's concurrence. Aside from Justice White's statement that he was glad to join the majority opinion and the substance of his remarks, Justice White did not articulate an alternative rationale. Justice White merely stated what the Court did not hold, which is not inconsistent with the majority opinion.

The Ninth Circuit followed *Commonwealth Coatings* in *Schmitz v. Zilveti,* 20 F.3d 1043 (9th Cir.1994). In that case the district court had denied vacatur because the arbitrator was unaware of his firm's representation of the parent company of a party because he had run a conflict check on the party but not the parent company, and therefore no evident partiality existed. The Ninth Circuit correctly distinguished cases of bias or appearance of bias and failure to disclose, rejected the view that *Commonwealth Coatings* was only a plurality decision, and applied the non-disclosure rule of the Supreme Court.

The judicial disfavor of *Commonwealth Coatings,* while receiving surprisingly little treatment, has not gone unnoticed by commentators. One observed that "[f]ederal courts have floundered in the wake of *Commonwealth Coatings*" treating Justice White's concurrence as authoritative and standing for a different holding even though Justice White "does not expressly define the standard that should govern arbitrator conduct. His opinion only makes it clear that . . . arbitrators will be governed by a standard less than the standard governing judges." Elizabeth A. Murphy, Note, *Standards of Arbitrator Impartiality: How Impartial Must They Be?,* 1996 J. Disp. Resol. 463, 470.

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[3] *Apperson,* 879 F.2d at 1358 n. 19; *Morelite Constr. Corp.,* 748 F.2d at 83; *Merit Insurance Co.,* 714 F.2d at 681-82; *Middlesex Mutual Ins. Co.,* 675 F.2d at 1200.

While I can understand the desire to protect the finality of arbitration awards and avoid a return to extended court expense and delay, this does not justify evading the law of the Supreme Court by misstating it or by avoiding it by bleaching the evidence of possible partiality. Nor should we miss the need to promote the impartiality of arbitrators in this time when that is the favored method of dispute resolution. Influence can so easily corrupt the decision-making process even when it is not recognized by the magistrate or arbitrator himself. And to prove bias or improper influence is rarely possible. It is imperative that we not allow even the good faith or memory of the potential arbitrator to control the disclosure decision for, as the Justices made clear in *Commonwealth Coatings,* it is the protection and reassurance of the party that matters most.[4]

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[4] Perhaps the rule should be different when disclosure of all relationships is expressly required to be made at the outset.

And perhaps some allowance should be made for a three member panel of arbitrators, as distinguished from the selection of a single arbitrator by the parties.

The Supreme Court in *Commonwealth Coatings* derived the statutory authority for vacating the award on the grounds of evident

(Continued on following page)

Positive Software v. New Century Mortgage

Coming to the case on appeal, New Century seeks borrowers by telemarketing and employs computer devices to call prospects. In January of 2001, New Century obtained a license from Positive Software to use the software product Loan Force developed by Positive Software. Positive Software was then told by former employees of New Century that it was reverse-engineering or copying Loan Force in the effort to develop its own software and dispense with Loan Force. The Software Subscription Agreement, ¶ 7A, prohibited that conduct. Positive Software terminated the license, called for an audit and return of its software, and filed this lawsuit in February of 2003.

Despite assurances by counsel of New Century, efforts by Positive Software and the court for the return of the software and disclosure of its use failed. Positive Software enlisted the aid of the district court in a series of hearings in March and April that culminated on April 28, 2003 in an injunction and protective order by the court, based on a finding that New Century had copied Positive Software's material and enjoining New Century from use of Loan Force software, its database, or the software New Century was claiming to be its own products. Positive Software then moved for a default judgment on the ground that New Century had destroyed evidence. The district court sent the parties to mediation and hearings before a magistrate judge. Finally, on September 26, 2004, the district judge found that its orders had been violated in an order

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partiality or the use of undue means. 9 U.S.C. § 10. It might also be said that an arbitrator who fails to make a significant disclosure is guilty of "misbehavior by which the rights of any party have been prejudiced." § 10(a)(3).

telling the disturbing story. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F.Supp.2d 862 (N.D.Tex.2004).

Meanwhile the dispute had gone to arbitration where the award favored New Century completely. The award found that there had been no infringement or breach of the licensing contract and charged Positive Software with several million dollars of damages, fees, and costs.

At the outset of his ruling the arbitrator ridiculed Positive Software's claim and wrote: "It involves a saga of how failure to renew an $86,100 software license has led to a claim for $500,000,000 in damages in this arbitration, and for $38,000,000,000 in Federal Court." The district court expressed curiosity about the explanation for this statement of the arbitrator's disdain. 337 F.Supp.2d at 886 n. 23.

Susman Godfrey and the Arbitrator

Positive Software searched for an answer to this award and found a prior relationship between counsel for New Century, the Susman Godfrey law firm, and the arbitrator, Peter J. Shurn, a member of the Arnold White & Durkee firm. These two prominent law firms in Houston both represented Intel in its protracted patent litigation with Cyrix.[5] Susman Godfrey began the representation of Intel in August 1991, with Stephen Susman, Terrell Oxford, and Ophelia Camiña appearing. Peter Shurn joined the team in September 1992. He was listed thereafter with

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[5] *Cyrix Corp. v. Intel Corp.*, 879 F.Supp. 666 (E.D.Tex.1995); *Cyrix Corp. v. Intel Corp.*, 879 F.Supp. 672 (E.D.Tex.1995); *Cyrix Corp. v. Intel Corp.*, 803 F.Supp. 1200 (E.D.Tex.1992).

Susman, Oxford, and Camiña on docket sheets, motions, pleadings, and briefs.

The only response from Susman Godfrey or New Century is a statement by Ophelia Camiña that her involvement with the Intel litigation began in 1991 and ended in 1992. But her name and that of Shurn appeared together on multiple pleadings between September 1992 and June 1993. Camiña is shown with Shurn, Susman, and Oxford on a trial motion filed January 19, 1993. And the four appeared together on motions and Intel's notice of appeal filed in 1993. She also appears with Susman Godfrey and Arnold White & Durkee in the list of counsel on an opinion in 1994.

These lawyers were not inactive participants in the Cyrix litigation. One letter was found written by Stephen Susman to opposing counsel detailing the witnesses Intel intended to call at trial, and a copy of the letter went to Peter J. Shurn.

There is no explanation of this relationship from Shurn or Terry Oxford or any member of Susman Godfrey other than Camiña. The district court said that the fact that Camiña's name remained on pleadings and court records, for years after she claimed to have ended her participation, itself gives the appearance of impropriety. *Id.* at 885.

When Shurn was being considered to arbitrate this dispute, he was told the names of counsel and told of the importance of disclosing any relationship with them. He signed a disclosure for the American Arbitration Association saying that he had nothing to disclose of past relationship with the parties or their counsel, "direct or indirect, whether financial, professional, social or of any other kind." He was further instructed: "If any relationship arises during the course of the arbitration, or if there is any change . . . it must also be disclosed." When Shurn was appointed he was asked: "Have you had any professional or social relationship with counsel for any party in this proceeding or the firms for which they work?" He checked: "I have nothing to disclose." And he signed an oath that he would act in accord with the rules of the American Arbitration Association.

The majority opinion portrays this relationship as trivial by reducing the record to Camiña's statement that she did no work with Shurn. The district court had a different picture of the relationship, one that would have been remembered if Shurn or the other lawyers had given any thought to it, and certainly would have prevented Positive Software from resting its case with Peter Shurn.

Positive Software asked the district court for more discovery of the relationship between the arbitrator and the Susman Godfrey firm, but this request was not granted because the record had already established a failure to disclose a relationship requiring vacatur under the rule of *Commonwealth Coatings.*

Positive Software has also asked the courts to allow the dispute now to be tried in the good hands of the judiciary, because it cannot afford the expense of another arbitration. Anyone familiar with the experience of Positive Software will understand that request. Further, one will understand the wisdom of the Supreme Court's ruling in *Commonwealth Coatings.* And, finally, one would follow that ruling and affirm the judgment vacating this arbitration award.

WIENER, Circuit Judge, Specially Concurring in Circuit Judge REAVLEY's dissent, joined by REAVLEY, Circuit Judge:

As I wholeheartedly concur in Judge Reavley's dissent, I write separately only to add a perspective that I find helpful in analyzing this case and demonstrating that Judge Reavley has gotten it right. I refer in general to the key differences between arbitration under the FAA and litigation in federal court; I refer in particular to one difference that is of prime significance in this case, viz., the disparate ways that the decision maker – an Article III judge on the one hand and an arbitrator on the other – is selected, and the unique role of the potential arbitrator's unredacted disclosure of his relationships with the parties and their counsel to ensure selection of an impartial arbitrator. These general and particular differences underscore why such full and fair disclosure by a potential arbitrator of *every* conceivable relationship with a party or counsel, however slight, is a prerequisite. No relationship with a party or a lawyer is too minimal to warrant its *disclosure,* even if, in the end, it might be deemed to be too minimal to warrant *disqualification.* Such an evaluation by the potential arbitrator, and any withholding of information based on it, are simply not calls that he is authorized to make, yet ones that Lawyer Shurn obviously made.

The penumbral point that supervenes this case lies in our recognition of the legal distinction between *disclosure* and *disqualification* in the context of arbitration. Justice White, in his celebrated and thoroughly vetted concurrence in *Commonwealth Coatings Corp.,* "remarked" that the Supreme Court was *not* deciding that "arbitrators are to be held to the *standards of judicial decorum* of Article III judges" or that arbitrators are "automatically *disqualified* by a business relationship" with the parties to arbitration or their counsel.[1] What must be emphasized is that Justice White did *not* "remark" that the differences between the standards of decorum applicable to judges and those to which arbitrators are held has anything at all to do with the immutable prerequisite that, before the parties sign off on a candidate for arbitrator, they must have received from him an unexpurgated disclosure of absolutely every past or present relationship with the parties and their lawyers.[2] That the potential arbitrator himself might deem one or more of such relationships to be so *de minimis* as not to require its divulgence is irrelevant; such culling of information by a candidate must never be allowed to seep interstitially into the *disclosure* calculus. Justice White's remark that *disqualification* is not automatic for minor business relationships is simply inapposite to the requirement of full *disclosure* of every relationship, large and small. This is because, in arbitration, disqualification (more accurately, rejection) is the exclusive province of the parties, each of whom is entitled to make its determination on the basis of total disclosure of relationships, not on the basis of some truncated version that has been cherry-picked by the nominee for the position of arbitrator.

Most who have commented on Justice White's statement have failed to analyze its full import in depth, treating it either as a tautological musing or as a starting point for holding arbitrators to a lesser degree of impartiality and "recusability" than trial judges. I am convinced, though, that Justice White meant much more, at least regarding the absolute nature of the duty of a potential arbitrator to disclose every relationship large and small. This is because he and the other justices who joined the Black opinion knew full well *who* it is that has the sole authority and duty to determine whether a candidate for the post of arbitrator should be accepted or rejected: the parties and they alone.

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[1] Emphasis mine.

[2] As noted by Justice White, "relationship" here does not include mere chance encounters or personal introductions.

The tradeoffs attendant on the dispute-resolution choice between litigation and arbitration are well and widely known: The principal benefits usually ascribed to arbitration are speed, informality, cost-savings, confidentiality, and services of a decision-maker with expertise and familiarity with the subject matter of the dispute. These "pluses," however, are not without offsetting "minuses." The informalities attendant on proceedings in arbitration come at the cost of the protections automatically afforded to parties in court, which reside in such venerable institutions as the rules of evidence and civil procedure. Likewise sacrificed at the altar of quick and economical finality is virtually the entire system of appellate review, as largely embodied for the federal courts in rules of appellate procedure and the constantly growing body of trial, appellate, and Supreme Court precedent interpreting and applying such rules. By dispensing with such basic standards of review as clearly erroneous, *de novo,* and abuse of discretion, there remain to parties in arbitration only the narrowest of appellate recourse.

A less frequently encountered and less frequently discussed distinction and its tradeoffs is the one implicated here: the vital difference between the method by which a federal judge is selected to hear a case in litigation vis-à-vis the method by which arbitrators are selected – a distinction hinted at by Justice White but frequently overlooked or misinterpreted. All know that trial judges in the federal system are nominated and confirmed only after a rigorous testing of their capabilities, experience, and integrity. In contrast, arbitrators are quickly selected by the parties alone, who frequently have unequal knowledge of or familiarity with the full history of potential arbitrators. Federal trial judges are full-time dispute resolvers; the experience of arbitrators falls all along the experience spectrum, from those who might serve but once or twice in a lifetime to those who conduct arbitration with increasing regularity. The trial judge who is to hear a case is almost never "selected" by or agreed on by the parties; rather, such judge is "selected" or designated by objectively random or blind assignment through long established court procedures (except in the rare case of a party's successful forum shopping in a single-judge district, or consenting to try a case to a known magistrate judge). In stark contrast, it is the parties to arbitration themselves who have sole responsibility for the selection of their arbitrator or arbitrators.

It follows then that because they alone do the selecting, the parties to arbitration must be able to depend almost entirely on the potential arbitrator's good faith, sensitivity, understanding, and compliance with the rules of disclosure by candidates for the post. And, even then, appellate relief is an avis rara when it comes to questions of bias, prejudice, or non-disclosure in arbitration. Consequently, except for such background checks that the parties might be able to conduct, the only shield available to the parties against favoritism, prejudice, and bias is full and frank disclosure, "up front," by each potential arbitrator. And even that is far less efficacious than the safeguards that are afforded to parties in litigation through the elaborate rules of professional conduct, disqualification, and recusal, and the body of law and procedure thereon developed in the crucible of the very formal and extensive judicial system.

The point that I belabor here is that, because parties to arbitration have virtually none of the protections against prejudice and bias (or the appearances thereof) that are automatically and routinely afforded to litigants in federal court, the single arrow remaining in the otherwise-empty quiver of protection afforded to parties in arbitration – full, unredacted disclosure of every prior relationship – must be rigorously adhered to and strenuously enforced. Indeed, it is these very differences in the *disclosure* standards – not *disqualification* standards – to which judges are held vis-à-vis those to which arbitrators are held that demand unyielding fealty to both the letter and spirit of the disclosure requirement: With such a slim safeguard against bias or the appearance of bias in arbitration, the reason is obvious why such mandated disclosure of *every* relationship, without self-abridgment by the potential arbitrator, must be assiduously enforced.

In federal court, it is the system and the judges who perform the "gatekeeper" function to exclude decision-maker favoritism or its appearance. In arbitration, though, it is the parties who are the gatekeepers, and not the potential arbitrators or the arbitration associations (or their rules). Filtration of partiality in arbitration is the exclusive prerogative and duty of the *parties* – and only the parties – as it is they alone who select the decision maker. As gatekeepers, the parties are charged with guarding against favoritism and prejudice, a duty that they cannot possibly discharge in the absence of total disclosure.

In exchange for the actual or perceived economies of time, money, expertise and confidentiality, the parties to arbitration alone are responsible for who it is that will decide their fates. Subject to only relatively insignificant limitations, the parties (or in the case of panels, each party's selected arbitrator) have virtually absolute control over accepting or rejecting a nominee for the role of decision maker. It cannot therefore be left to the fox, who is the potential arbitrator, to guard the arbitration henhouse, secretly identifying to himself alone all "prior or present relationships," then just as secretly deciding which are worthy of disclosure and which are not. On the contrary, avoidance of partiality in the selection of the arbitrator can be achieved only if, in discharging his duty of disclosure, the potential arbitrator objectively disgorges absolutely every conceivable fact of prior or present relationships with parties or counsel, regardless of how tenuous or remote they might seem to him. He must leave to the parties the value judgment as to which (if any) among those fully disclosed facts constitutes a basis for rejecting the potential arbitrator for bias or the appearance of bias. Only of and after that is done can *disclosure* translate into *disqualification* or rejection.

Thus the system fails when the nominee for the post of arbitrator takes it upon himself to make the value judgment whether a relationship is so inconsequential that it need not be disclosed at all. Arbitration's scant protection against bias and favoritism obviously breaks down completely when the question whether a relationship should be disclosed is assumed *sub silentio* by the potential arbitrator rather than by disclosing all and allowing the parties to make that call following their receipt of all facts through an unabridged disclosure.

Who knows? If Shurn had dutifully reported his prior professional relationships and interaction with counsel for New Century, counsel for Positive Software might nevertheless have accepted Shurn. But Shurn's very act of preemptively deciding, solely on his own, that his prior relationship with counsel for New Century need not be disclosed and then withholding that information, conveys an unmistakable appearance of impropriety. To me, that misstep is more than sufficient to support the objections of Positive Software that it was deprived of its right to be informed of the prior relationship between Shurn and the Susman, Godfrey firm, and to make its own evaluation of the significance of that connection.

I end where I began: The vast gulf between resolving disputes in federal court and resolving them in arbitration – especially the often overlooked distinction between disclosure and disqualification and between who plays the gatekeeper role of selecting the decision maker – frames the issue we decide today. In arbitration, full disclosure is the proverbial slender reed against which we lean prevention of favoritism to prop up the highly circumscribed ability of a party to ferret out a candidate's prior relationships and then determine whether, as to that party, the relationship does or does not impinge on impartiality. This anorexic reed must not be further slenderized, as the majority does today. For the system to enjoy credibility, each potential arbitrator absolutely must disclose every relationship with the parties and counsel, no matter how minimal or insignificant the aspiring arbitrator might deem it to be. For it is not the prerogative of the candidate to pick and choose, but the prerogative of the parties alone to decide such significance. And that cannot be done with any degree of comfort absent full disclosure. These reasons and those expressed by Judge Reavley compel me to concur in his dissent.

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 04-11432

D.C. Docket No. 3:03-CV-257

POSITIVE SOFTWARE SOLUTIONS, INC

Plaintiff-Appellee

v.

NEW CENTURY MORTGAGE CORPORATION;
NEW CENTURY FINANCIAL CORPORATION;
eCONDUIT CORPORATION; THE ANYLOAN
COMPANY, JEFF LEMIEUX; FRANK NESE

Defendants-Appellants

Appeal from the United States District Court for the
Northern District of Texas, Dallas.

Before JONES, Chief Judge, and REAVLEY, JOLLY, HIGGINBOTHAM, DAVIS, SMITH, WIENER, BARKSDALE, GARZA, DeMOSS, BENAVIDES, STEWART, DENNIS, CLEMENT, PRADO, and OWEN, Circuit Judges.*

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* KING, Circuit Judge, did not participate in the decision.

JUDGMENT ON REHEARING EN BANC

(Filed Jan. 18, 2007)

This cause came on to be heard on rehearing en banc and was argued by counsel.

It is ordered and adjudged that the judgment of the District Court is reversed, and the cause is remanded to the District Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that plaintiff-appellee pay to defendants-appellants the costs on appeal to be taxed by the Clerk of this Court.

REAVLEY, Circuit Judge, with whom WIENER, GARZA, BENAVIDES, and STEWART, Circuit Judges, join, dissenting:

WIENER, Circuit Judge, specially concurring in Judge Reavley's dissent, joined by REAVLEY, Circuit Judge:

ISSUED AS MANDATE:

436 F.3d 495

United States Court of Appeals, Fifth Circuit.
POSITIVE SOFTWARE SOLUTIONS, INC.,
Plaintiff-Appellee,
v.
NEW CENTURY MORTGAGE CORPORATION,
New Century Financial Corporation, Econduit
Corporation, The Anyloan Company, Jeff Lemieux,
Frank Nese, Defendants-Appellants.
No. 04-11432.

Jan. 11, 2006.

Michael W. Shore (argued), Shore Chan, Alfonso Garcia Chan, Akin, Gump, Strauss, Hauer & Feld, Dallas, TX, for Plaintiff-Appellee.

Sharon N. Freytag, Robin P. Hartmann, Ronald Wayne Breaux, Anne M. Johnson (argued), Haynes & Boone, Ophelia S. Camina, Kenneth E. Gardner, Susman Godfrey, Dallas, TX, for Defendants-Appellants.

Peter S. Vogel, Gardere Wynne Sewell, Dallas, TX, for Lemieux and Nese.

Appeal from the United States District Court for the Northern District of Texas.

Before REAVLEY, GARZA and BENAVIDES, Circuit Judges.

REAVLEY, Circuit Judge:

The question here is whether an arbitrator's failure to disclose that seven years before the arbitration, he and his former law firm were co-counsel in a lengthy litigation matter with one of the law firms and counsel in this matter, justifies vacating the award. We hold that the arbitrator was required to disclose the relationship because it might have created an impression of possible bias, and we affirm the district court's judgment vacating the arbitration award; but we vacate the portion of the district court's judgment that regulates a subsequent arbitration.

I.

A.

New Century Mortgage Corporation ("New Century") is in the mortgage business. It generates business through telephone contacts with prospective borrowers. Positive Software Solutions, Inc. ("Positive Software") develops, markets, and manufactures computer-software products for the mortgage industry. It developed "LoanForce," a software product that is a relational database for use in the mortgage lending business.[1] Positive Software licensed LoanForce to New Century pursuant to a Software Subscription Agreement ("SSA"). Positive Software learned that New Century was allegedly copying LoanForce and was incorporating it into different software products. Thereafter, Positive Software filed this lawsuit alleging, *inter alia,* claims of copyright infringement, theft of trade secrets, breach of contract, seeking specific performance, money damages, and preliminary and permanent injunctive relief. The district court granted Positive Software's motion for a preliminary injunction enjoining New Century from using LoanForce.[2] In addition, the district court compelled arbitration pursuant to the SSA.[3]

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[1] *Positive Software Solutions, Inc. v. New Century Mortgage Corp.,* 259 F.Supp.2d 531, 533-34 (N.D.Tex.2003) (discussing the inner workings of the LoanForce software).

B.

Arbitration of this matter took place under the auspices of the American Arbitration Association ("AAA"). Pursuant to AAA procedures, the AAA provided the parties with a list of candidate arbitrators, along with their *curricula vitae,* and requested that the parties rank the candidates. Both parties provided their lists of acceptable arbitrators to the AAA, ranking them in the order of preference as instructed. Peter J. Shurn, III was one of the five arbitrator candidates listed. The parties jointly selected Shurn to arbitrate this case as he received the highest combined ranking from the parties.[4]

The AAA contacted Shurn by letter to determine his availability. That letter listed the names of the parties and counsel, including designating Susman Godfrey L.L.P. ("Susman Godfrey") as the firm representing New Century, and one if its partners, Ophelia F. Camiña, as New Century's arbitration counsel. At the bottom of the letter, there was an "important reminder" advising arbitrators of their "obligation to disclose any circumstance likely to affect impartiality or create an appearance of partiality."

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[2] *Id.* at 535-37.

[3] *Id.* at 538-40. Positive Software appealed the district court's order on this issue and this court dismissed that appeal for lack of jurisdiction. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.,* 90 Fed.Appx. 728 (5th Cir.2004).

[4] Positive Software objected to two of the five arbitrators on the AAA list and ranked Shurn first among the others. New Century ranked Shurn third out of five.

The same "important reminder" appeared in two subsequent letters addressed to Shurn.

Shurn signed and returned the standard "Notice of Appointment" form to the AAA, which advised arbitrators to "please disclose any past or present relationship with the parties, their counsel, or potential witnesses, direct or indirect, whether financial, professional, social or any other kind. . . . " That letter included twelve questions to assist arbitrators in determining whether any "past or present relationship" required disclosure, including the following question, "Have you had any professional or social relationship with counsel for any party in this proceeding or with the firms for which they work?" Shurn indicated that he had nothing to disclose.

After a seven-day hearing, in a written ruling, Shurn found that New Century did not infringe Positive Software's copyrights, did not misappropriate Positive Software's trade secrets, did not breach the SSA, and did not defraud or conspire against Positive Software. Shurn ordered that Positive Software take nothing.

C.

Following the arbitration award, Positive Software conducted a detailed investigation into Shurn's background. It discovered that Shurn and his former law firm, Arnold White & Durkee ("Arnold White"), had been involved in a professional relationship with Susman Godfrey and Camiña, New Century's arbitration counsel, for a period of time.

Soon thereafter, Positive Software filed a motion to vacate the arbitration award. The district court granted

Positive Software's motion on the ground that Shurn failed to disclose that he had "served as co-counsel with New Century's counsel over a period of years in significant litigation," and that this prior relationship "might create a reasonable impression of possible bias."[5] Further, Shurn's "failure to disclose that relationship deprived Positive Software of the opportunity to make an informed choice of arbitrators and requires vacatur of the award."[6]

The district court found that Intel and Cyrix were involved in "protracted patent litigation" for seven years, beginning in 1990 and ending in 1996.[7] Also, the district court found that Susman Godfrey and Arnold White represented Intel as co-counsel from the beginning of the action, Camiña appeared for Intel early in the litigation, and Shurn began representing Intel in September 1992.[8] New Century claimed that Camiña's personal involvement in the case ended in July 1992, but the district court found that her name continued to appear with Shurn's name on pleadings as late as June 1993 and, further, a 1995 court opinion reflected that Susman Godfrey and Camiña, together with Arnold White, represented Intel.[9]

The district court further found that had Positive Software been aware of Shurn's prior relationship with Susman Godfrey and Camiña, it would not have ranked Shurn highly, and he would not have been chosen as the arbitrator.[10] The district court outlined the numerous reminders and opportunities that Shurn had to disclose his past professional relationship with Susman Godfrey and Camiña, and that he failed to do so.[11]

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[5] *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F.Supp.2d 862, 878 (N.D.Tex.2004).

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

The district court held that any reasonable lawyer selecting a sole arbitrator for arbitration would have wanted to know that the arbitrator chosen had a prior association with opposing counsel, given the contentious nature of the dispute between the parties and the duration and importance of the prior litigation with which both arbitrator and opposing counsel were associated.[12] Therefore, Shurn's failure to disclose his prior relationship with opposing counsel created a reasonable impression of possible partiality that warranted vacating the award.[13] The district court also held that Positive Software did not learn of Shurn's prior professional relationship until after the arbitration and, therefore, did not waive its objection to the nondisclosure.[14]

The district court also ordered that in the next arbitration, the parties must refrain from certain practices, including referring to any ruling of the first arbitrator and advising the new arbitrator of the first arbitrator's award.[15] After staying the second arbitration proceeding, this appeal followed.

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[10] *Id.* at 879.

[11] *Id.* at 879-80.

[12] *Id.* at 885.

[13] *Id.*

[14] *Id.*

[15] *Id.* at 887.

II.

We review a district court's decision to vacate an arbitration award under the same standard as any other district court decision.[16] We accept findings of fact that are not clearly erroneous and decide questions of law de novo.[17] We also review the application of law to fact de novo.[18]

III.

A.

Congress promulgated the United States Arbitration Act, 9 U.S.C. §§ 1-14, in 1925, to delineate the thorny relationship between the role of private arbitration and the federal courts. Section 10 of the Act provides the grounds upon which a court may vacate an arbitrator's award, and for our purposes, states that such a basis exists "[w]here there was evident partiality ... in the arbitrator[ ]. . . ."[19]

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[16] *Hughes Training Inc. v. Cook*, 254 F.3d 588, 592 (5th Cir.2001).

[17] *Id.*

[18] *Walker Int'l Holdings Ltd. v. Republic of Congo*, 395 F.3d 229, 233 (5th Cir.2004). Relying on *Thornburg v. Gingles*, 478 U.S. 30, 78-79, 106 S.Ct. 2752, 2780-81, 92 L.Ed.2d 25 (1986), wherein the Supreme Court held that the district court's ultimate finding of vote dilution, which "requires the application of a rule of law to a particular set of facts," is subject to the clearly erroneous standard of review because "[t]his determination is peculiarly dependent upon the facts of each case," Positive Software urges this court to review the application of law to fact for clear error because a nondisclosure claim is peculiarly dependent upon the facts of each case. We are unpersuaded and decline to apply the clearly erroneous standard of review to the application of the law to the facts. When this court has applied law to facts in cases concerning the Federal Arbitration Act, we have conducted de novo review. *See, e.g., Kergosien v. Ocean Energy, Inc.*, 390 F.3d 346, 352 (5th Cir.2004); *Forsythe Int'l S.A. v. Gibbs Oil Co. of Texas*, 915 F.2d 1017, 1021 (5th Cir.1990). In addition, other circuits that have considered nondisclosure in arbitration cases have applied de novo review when applying law to facts. *See, e.g., Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 51 F.3d 157, 160 (8th Cir.1995); *Schmitz v. Zilveti*, 20 F.3d 1043, 1045 (9th Cir.1994).

Deciding what constitutes "evident partiality" in an arbitrator and the use of "undue means" has proved troublesome. The case law in this area is confusing and complicated. While this court has not previously determined the scope of this standard,[20] numerous courts in other jurisdictions, including the Supreme Court, have done so. We analyze those cases.

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[19] 9 U.S.C. § 10(a)(2). 9 U.S.C. § 10 provides in full:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration-
>
> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.
>
> (b) If an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators.
>
> (c) The United States district court for the district wherein an award was made that was issued pursuant to section 580 of title 5 may make an order vacating the award upon the application of a person, other than a party to the arbitration, who is adversely affected or aggrieved by the award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 572 of title 5.

The case of *Commonwealth Coatings Corp. v. Continental Cas. Co.*,[21] involved an arbitration panel composed of two arbitrators chosen by each of the parties and a third "neutral" arbitrator who had previously worked for one of the parties to the arbitration. The neutral arbitrator voted with the panel for an award in favor of the party with whom he had done business.[22] Thereafter, the party that lost the arbitration challenged the award, claiming that the failure of the arbitrator to disclose his significant business relationship resulted in "evident partiality" under 9 U.S.C. § 10, warranting vacatur of the award.[23]

Justice Black, in delivering the Court's opinion, concluded that the arbitrator's failure to disclose warranted vacating the award for evident partiality even though there was no evidence of actual bias.[24] The Court noted that arbitrators are not expected to sever ties with the business world, but nevertheless, it must be scrupulous in safeguarding the impartiality of arbitrators, as they have "completely free rein to decide the law as well as the facts and are not subject to appellate review."[25] As a result, the Court imposed "the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias."[26]

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[20] The closest this court came to addressing the "evident partiality" standard was in *Bernstein Seawell & Kove v. Bosarge,* 813 F.2d 726 (5th Cir.1987). There, this court stated in dicta that the "appearance of bias" is insufficient to warrant vacatur. *Id.* at 732. The standard for vacating an arbitration award for evident partiality has not been definitively addressed in this circuit.

[21] 393 U.S. 145, 146, 89 S.Ct. 337, 338, 21 L.Ed.2d 301 (1968).

[22] *Id.*

[23] *Id.*

[24] *Id.* at 148-49, 89 S.Ct. at 339-40.

In a concurring opinion, Justice White, joined by Justice Marshall, specifically stated that he joined the Court's "majority opinion," and he emphasized that the parties must be cognizant of all non-trivial relationships in order to exercise full and fair judgment.[27] Justice White agreed on a rule of full disclosure:

> [I]t is far better that the relationship be disclosed at the outset, when the parties are free to reject the arbitrator or accept him with knowledge of the relationship and continuing faith in his objectivity, than to have the relationship come to light after the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award.[28]

Although Justice White indicated that he was "glad to join" Justice Black's opinion and that he desired to make "additional remarks," and Justice Black's opinion was designated the "opinion of the court," some lower federal courts have seen a conflict between the two writings.[29]

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[25] *Id.* at 149, 89 S.Ct. at 339.

[26] *Id.*

[27] *Id.* at 151, 89 S.Ct. at 340.

[28] *Id.*

[29] The opinion in *Commonwealth Coatings* is often referred to as a "plurality opinion." *See, e.g., Apperson v. Fleet Carrier Corp.,* 879 F.2d 1344, 1358 n. 19 (6th Cir.1989); *Int'l Produce, Inc. v. A/S Rosshavet,* 638 F.2d 548, 551 (2d Cir.1981). In *Schmitz,* the Ninth Circuit explained why it believes the label is incorrect:

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Accordingly, by treating Justice Black's opinion as a plurality opinion, some courts have felt free to reject Justice Black's statement that "evident partiality" is met by an "appearance of bias," and to apply a much narrower standard.

An early example of this occurred in *Morelite Constr. Corp. v. New York City District Council Carpenters Benefit Funds.*[30] There, the court referred to Justice Black's opinion as a mere plurality of four justices and read much of that opinion as dicta.[31] The court reasoned that something more than an "appearance of bias" was necessary to disqualify an arbitrator, but this was not a case of failure

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> Because three other justices dissented, the vote of either Justice White or Justice Marshall was necessary to the formation of a majority voting for reversal. Justice White's concurrence has therefore been given particular weight. *Commonwealth Coatings* is not a plurality opinion, however. Justice White said he joined in the "majority opinion" but wrote to make "additional remarks."

20 F.3d at 1045 (citation omitted).

We add that Justice White's concurring opinion is not irreconcilable with Justice Black's opinion. Notably, Justice White never mentions the "appearance of bias" standard or suggests that it is inappropriate. Rather than rejecting the "appearance of bias" standard, Justice White embraces it and attempts to more precisely define its parameters. *See Commonwealth Coatings,* 393 U.S. at 151, 89 S.Ct. at 340 ("arbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial"). In fact, Justice White's concurring opinion complements the Court's opinion by encouraging "frankness at the outset." *Id.* Thus, both opinions share the same goal-full disclosure at the outset.

[30] 748 F.2d 79 (2d Cir.1984).

[31] *Id.* at 82-83.

to disclose.[32] Other federal circuits have adopted a similar "evident partiality" standard.[33]

Other federal circuits, centering on the need for full disclosure to parties who are choosing their own arbitrators, have adopted a much broader standard. One such case is *Schmitz,* wherein the Ninth Circuit held that an arbitrator had a duty to disclose that his law firm had represented the parent company of a party to the arbitration.[34] After determining that Justice Black's opinion in *Commonwealth Coatings* was controlling precedent, the court stated that the "best expression" of the Supreme Court's holding is that evident partiality exists when "undisclosed facts show a reasonable impression of partiality."[35] The court discussed the important distinction between cases in which actual bias is alleged and those involving allegations of failure to disclose, observing that although the "reasonable impression of partiality" standard may not be appropriate in actual bias cases (though it has, confusingly, been used by some courts in those cases), it is the correct standard for nondisclosure cases:

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[32] *Id.* at 83-84.

[33] *See Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.,* 991 F.2d 141, 146 (4th Cir.1993) (adopting the *Morelite* standard and holding that the arbitrator was unaware of the questioned relationship); *Apperson,* 879 F.2d at 1358 (adopting the *Morelite* standard and holding that the objection to the arbitrator had been waived); *Nationwide Mut. Ins. Co. v. Home Ins. Co.,* 429 F.3d 640 (6th Cir.2005) (declining to deviate from *Apperson*); *Health Servs. Mgmt. Corp. v. Hughes,* 975 F.2d 1253, 1264 (7th Cir.1992) (holding that the objection to the arbitrator was waived); *Ormsbee Dev. Co. v. Grace,* 668 F.2d 1140, 1147 (10th Cir.1982) ("only clear evidence of impropriety [] justifies the denial of summary confirmation of an arbitration award. . . . For an award to be set aside, the evidence of bias or interest of an arbitrator must be direct, definite and capable of demonstration rather than remote, uncertain or speculative.") (internal citations omitted); *ANR Coal Co., Inc. v. Cogentrix of N. Carolina, Inc.,* 173 F.3d 493, 500 (4th Cir.1999) (holding that mere nondisclosure does not itself justify vacatur).

[34] 20 F.3d at 1049.

[35] *Id.* at 1046.

> The policies of 9 U.S.C. § 10 . . . support the notion that the standard for nondisclosure cases should differ from that used in actual bias cases. In a nondisclosure case, the integrity of the process by which arbitrators are chosen is at issue. Showing a "reasonable impression of partiality" is sufficient in a nondisclosure case because the policy of section 10(a)(2) instructs that the parties should choose their arbitrators intelligently. The parties can choose their arbitrators intelligently only when facts showing potential partiality are disclosed. Whether the arbitrators' decision itself is faulty is not necessarily relevant. But in an actual bias determination, the integrity of the arbitrators' decision is directly at issue. That a reasonable impression of partiality is present does not mean the arbitration was the product of impropriety.[36]

Other courts have adopted a similarly broad standard of "evident partiality."[37]

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[36] *Id.* at 1047 (internal citation omitted).

[37] *See Middlesex Mut. Ins. Co. v. Levine,* 675 F.2d 1197, 1200-01 (11th Cir.1982) (adopting "reasonable impression of bias" standard); *Olson,* 51 F.3d at 159-60 (recognizing that disclosure of "even indirect ties" will aid the arbitration process); *see also Crow Constr. Co. v. Jeffrey M. Brown Assoc. Inc.,* 264 F.Supp.2d 217, 222-23 (E.D.Pa.2003) (noting the distinction between actual bias standard and appearance of bias standard, and adopting the latter).

State court are [sic] equally divided between the narrow view of *Morelite* and the broad view of *Schmitz. See Burlington N. R.R. Co. v.*

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B.

Having analyzed the case law, we address what standard to apply in this case. This is a nondisclosure case in which the parties chose the arbitrator.[38] Striking the balance of the competing goals of expertise and impartiality in the selection process, maintaining faithfulness to the Court's opinion in *Commonwealth Coatings,* and agreeing with the policy arguments set out in *Schmitz,* we hold that an arbitrator selected by the parties displays evident partiality by the very failure to disclose facts that might create a reasonable impression of the arbitrator's partiality. The evident partiality is demonstrated from the nondisclosure, regardless of whether actual bias is established.

Such a demanding disclosure rule ensures that the parties will be privy to a potential arbitrator's biases at the outset, when they are "free to reject the arbitrator or accept him with knowledge of the relationship and continuing

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TUCO, Inc., 960 S.W.2d 629, 634-35 (Tex.1997) (collecting cases); Philip L. Bruner & Patrick J. O'Connor, Jr., 6 Bruner and O'Connor on Construction Law § 20:129 n. 10 & n. 14 (2005) (same).

[38] It has been suggested that the standards may differ depending on whether the parties have the ability to select the arbitrator, *Schmitz,* 20 F.3d at 1047-48 (stressing that arbitrators should be able to choose their arbitrators wisely and adopting a "reasonable impression of partiality" standard for arbitrators chosen by the parties), as opposed to when the parties have no say in the selection of the arbitrator, *Morelite,* 748 F.2d at 81 (collective bargaining agreement provided for designation of single neutral arbitrator without input from the parties); *Apperson* 879 F.2d at 1347 (same). Because the parties played no role in the selection of the arbitrator, *Morelite* and *Apperson* focused on whether the conflict was so severe as to indicate partiality or bias. *Morelite,* 748 F.2d at 84; *Apperson,* 879 F.2d at 1358-60. Whereas, because the parties selected the arbitrator, *Schmitz* focuses on whether the parties have access to all relevant information. *Schmitz,* 20 F.3d at 1047-48. In the instant case, we need not decide whether this matters.

faith in his objectivity," and allow the parties, who are "far better informed of the prevailing ethical standards and reputations within their business," to be the "architects of their own arbitration process."[39] A simple disclosure requirement minimizes the role of the courts in weighing arbitrators' potential conflicts,[40] and at the same time, minimizes the discretion of the arbitrators in determining what to reveal.[41] In addition, as the district court stated, "the full disclosure rule of *Commonwealth Coatings* reinforces the parties' expectations that arbitrators will abide by the Rule of the American Arbitration Association (and related rules), which the Supreme Court deemed 'highly significant.' "[42]

The standard we adopt comports with Canon II of the AAA's Code of Ethics for Arbitrators in Commercial Disputes ("Code of Ethics"),[43] which provides, in relevant part:

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[39] *Commonwealth Coatings,* 393 U.S. at 151, 89 S.Ct. at 340 (White, J., concurring).

[40] *Sanko S.S. Co., Ltd. v. Cook Indus., Inc.,* 495 F.2d 1260, 1263-64 (2d Cir.1973) (a demanding disclosure rule ensures that "the role of the judiciary in determining an arbitrator's impartiality after an award has been made will be significantly reduced").

[41] *Commonwealth Coatings,* 393 U.S. at 151, 89 S.Ct. at 340 (White, J., concurring) ("In many cases the arbitrator might believe the business relationship to be so insubstantial that to make a point of revealing it would suggest he is indeed easily swayed, and perhaps a partisan of that party. But if the law requires the disclosure, no such imputation can arise.").

[42] *Positive Software,* 337 F.Supp.2d at 883 (quoting *Commonwealth Coatings,* 393 U.S. at 149, 89 S.Ct. at 339).

[43] We cite the Code of Ethics for discussion purposes only and are keenly aware that they are not binding on this Court, but are "highly significant." *Commonwealth Coatings,* 393 U.S. at 149, 89 S.Ct. at 339. In addition, we note the Code of Ethics was revised on March 1, 2004. Section (2) above now reads "any known existing or past financial,

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> A. Persons who are requested to serve as arbitrators should, before accepting, disclose:
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> * * *
>
> (2) Any existing or past financial, business, professional, family or social relationships which are likely to affect impartiality or which might reasonably create any appearance of partiality or bias. . . .
>
> * * *
>
> B. The obligation to disclose interests or relationships described in the preceding paragraph A is a continuing duty which requires a person who accepts appointment as an arbitrator to disclose, at any stage of the arbitration, any such interests or relationships which may arise, or which are recalled or discovered.

We note that we are not adopting an inflexible *per se* rule in nondisclosure cases. While an arbitrator to be selected by the parties need not disclose relationships that are trivial, an arbitrator should always err in favor of disclosure.

C.

We now apply the standard we adopt to the facts of this case. Based on the facts of this case, New Century

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business, professional or personal relationships which might reasonably affect impartiality or lack of independence in the eyes of any of the parties. For example, prospective arbitrators should disclose any such relationships which they personally have with any party or its lawyer, with any co-arbitrator, or with any individual whom they have been told will be a witness. . . ."

contends that no matter what standard this court adopts, including the standard above, Positive Software cannot meet that standard. We disagree.

The district court found that Intel and Cyrix were involved in "protracted patent litigation" for seven years, beginning in 1990 and ending in 1996.[44] In addition, the district court noted that Susman Godfrey and Arnold White represented Intel as co-counsel from the beginning of the action, Camiña appeared for Intel early in the litigation, and Shurn began representing Intel in September 1992.[45] The district court discounted New Century's claim that Camiña's personal involvement in the cases ended in July 1992, because her name continued to appear with Shurn's name on pleadings as late as June 1993 (Shurn and Camiña's names appeared together on ten pleadings between September 1992 and June 1993) and a 1995 court opinion reflected that Susman Godfrey and Camiña, together with Arnold White, represented Intel.[46] We will not disturb these findings of fact.[47]

After reviewing the facts, we hold, like the district court did, that Shurn's past professional relationship with Susman Godfrey and Camiña might have conveyed an impression of possible partiality to a reasonable person. It is important to remember that the issue is only whether Shurn's prior professional relationship might reasonably give someone who is considering his services as an arbitrator the impression that he might favor one litigant over the other. It is not hard to think that Positive Software might not want to employ his services in an arbitration hearing with New Century once it discovered his prior relationship with the law firm and counsel representing New Century. On the other hand, Positive Software might decide that Shurn's qualifications as an arbitrator outweigh whatever concerns it might have. The point is simply that the information should have been disclosed to Positive Software so that it could make that decision. The integrity of the arbitral process demands no less.

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[44] *Positive Software*, 337 F.Supp.2d at 878.

[45] *Id.*

[46] *Id.*

[47] By relying on Camiña's affidavit, New Century downplays the relationship between Shurn and Camiña in the Intel litigation by pointing out that there were seven law firms and thirty-four different lawyers that represented Intel in the various stages of the lawsuit, that Shurn was involved in only one lawsuit in which Camiña and Susman Godfrey had worked, and that Shurn and Camiña had never met or spoke before the arbitration. The district court did not discuss these facts in its decision. Nevertheless, they do not change our analysis.

New Century argues that a finding of evident partiality under the facts of this case would make the job of finding a qualified arbitrator burdensome and would disqualify most attorneys from large firms from acting as arbitrators. We disagree. Qualified arbitrators would not be disqualified from acting as arbitrators, rather, they would merely have to disclose their past relationships, and then it would be for the parties to decide whether, based on the disclosure, the arbitrator merits objection.

We conclude that the district court properly vacated the arbitration award by reason of Shurn's failure to reveal to the parties his prior professional relationship with Susman Godfrey and Camiña. We hasten to add that we do not imply that Shurn was guilty of any wrongdoing or that he was in fact biased or influenced by reason of the relationship. Nevertheless, as Justice Black emphasized in *Commonwealth Coatings,* such relationships must be disclosed to the parties if the integrity and effectiveness of the arbitration process is to be preserved.[48]

IV.

New Century maintains that Positive Software waived its nondisclosure objection by failing to raise the issue until after the arbitration award. The district court found that Positive Software was unaware of the undisclosed relationship until after the arbitration, and accordingly, held that Positive Software did not waive its objection to the nondisclosure.[49]

This court has not considered the issue of waiver of a nondisclosure objection. Our sister circuits require *actual knowledge* of an arbitrator's potential partiality on the part of the complaining party prior to the arbitration proceeding as foundational to waiver.[50] We agree with our sister circuits and hold that one must have actual knowledge of the presence of a conflict of interest before one can waive the conflict. To hold otherwise, would turn the arbitration process on its head by shifting the onus from requiring an arbitrator to assume the duty of disclosure to requiring a party to assume a duty to investigate.[51]

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[48] 393 U.S. at 147-49, 89 S.Ct. at 339-40.

[49] *Positive Software,* 337 F.Supp.2d at 885.

[50] *See, e.g., Apperson,* 879 F.2d at 1359 (affirming the district court's conclusion that, "as a general rule, a grievant must object to an arbitrator's partiality at the arbitration hearing before such an objection will be considered by the federal courts" but highlighting that "[t]he successful party . . . may not rely on the failure to object for bias . . . unless '[a]ll the facts now argued as to [the] alleged bias were known . . . at the time the joint committee heard their grievances' "); *Middlesex,* 675 F.2d at 1204 ("Waiver applies only where a party has acted with full knowledge of the facts.").

Turning to the facts of this case, there is no evidence that Positive Software had actual knowledge of Shurn's past professional relationship with Susman Godfrey and Camiña. It is undisputed that Shurn never disclosed his past professional relationship with Susman Godfrey and Camiña. It was discovered through a post-award PACER[52] search. The uncontradicted affidavit testimony of two witnesses establishes that, if Positive Software had been aware of Shurn's previous professional relationship with Susman Godfrey and Camiña, it would have objected to him as the sole arbitrator. Based on these facts, we will not disturb the district court's finding that Positive Software did not learn of the professional relationship until after the arbitration, and therefore, did not waive its objection to the nondisclosure.

V.

In vacating the arbitration award, the district court ordered that in the second arbitration, the parties must refrain from certain practices, including referring to any ruling of the first arbitrator and advising the new arbitrator of the first arbitrator's award. New Century argues that the district court did not have the authority to dictate procedures for a second arbitration. We agree and hold that the district court erred in specifying procedures for the second arbitration.[53] Here, the district court lacked authority to go beyond vacating the award and dictating how the parties and the arbitrator should proceed in the second arbitration.

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[51] *Middlesex*, 675 F.2d at 1204.

[52] PACER, or the Public Access to Court Electronic Records System, is used by many federal courts to offer public access to docket information via the Internet.

VI.

The district court's judgment vacating the arbitration award is modified to vacate the portion of the district court's judgment that regulates a subsequent arbitration and, as modified, is affirmed.

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[53] *See Antwine v. Prudential Bache Sec., Inc.,* 899 F.2d 410, 413 (5th Cir.1990) ("Judicial review of an arbitration award is extraordinarily narrow."); *Gulf Guar. Life Ins. Co. v. Connecticut Gen. Life Ins. Co.,* 304 F.3d 476, 487 (5th Cir.2002) ("[C]hallenges to the procedural aspects of arbitration are for the arbitrator to decide, while challenges to the substantive arbitrability of disputes are for the courts to decide.").

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

POSITIVE SOFTWARE SOLUTIONS, INC. Plaintiff,	§	
v.	§	Civil Action No. 3:03-CV-0257-N
NEW CENTURY MORTGAGE CORPORATION, *et al.*, Defendants.	§	

MEMORANDUM OPINION AND ORDER

(Filed Sep. 28, 2004)

Before the Court are Plaintiff Positive Software Solutions, Inc.'s ("Positive Software") motions to hold defendant New Century Mortgage Corp., *et al.* (collectively, "New Century") in contempt for violation of the Court's preliminary injunction and protective order, and its motion to vacate the arbitration award.[1] The Court finds that New Century violated the protective order but that the protective order is not sufficiently clear and definite to be enforced by contempt. The Court also finds that the arbitrator failed to disclose a significant prior relationship with New Century's counsel. Because the failure to disclose that relationship creates a reasonable impression of partiality, the motion to vacate is granted.

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[1] New Century has reciprocal motions to hold Positive Software in contempt and to confirm the arbitration award.

I. NEW CENTURY'S VIOLATION OF THE PROTECTIVE ORDER WAS NOT CONTEMPTUOUS

The Court has great difficulty with New Century's conduct as disclosed in this Order. With considerable reluctance, however, the Court has determined that it should not address that conduct through the sanction of contempt.

A. *Factual Background*[2]

1. New Century and Positive Software's Prior Business Relationship. – New Century is in the mortgage business. It generates business through telephone contacts with prospective borrowers. Positive Software developed a software product called "LoanForce," which provides automated support for that process, in conjunction with other third-party supplied software. In 2000, New Century licensed LoanForce from Positive Software (the "Software Subscription Agreement" or "SSA"). Among other things, the SSA provides that New Century acknowledges that LoanForce is Positive Software's proprietary business information and agrees to return all such proprietary information to Positive Software upon termination of the SSA.

In late 2002 and early 2003, Positive Software became aware of a new software package that New Century was using called LoanTrack, together with what are apparently databases called LFMoon and LTKMoon (collectively, "LoanTrack-1"). Although Positive Software was not aware of the fact at the time, it presently appears that LoanTrack-1 was an interim product that New Century intended to use as it made a transition away from LoanForce to new products called LoanTrack-2 and MLAS. New Century claimed that LoanTrack-2 and MLAS were developed partly by in-house programmers and partly by a contractor called eConduit,[3] and that the programmers worked in a "clean room" environment with no access to the LoanForce code; that claim was false.

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[2] This section comprises the Court's factual findings in connection with the motions for contempt. Much of the language is drawn from the Court's prior fact findings in connection with other motions. Positive Software established the facts found in this section by clear and convincing evidence.

The Software Subscription Agreement required annual renewal and payment of license fees. During 2002, New Century told Positive Software that New Century might want to expand its LoanForce license to include all of New Century's branch offices. During that same time, New Century was preparing its transition away from LoanForce with the development of LoanTrack-1 and LoanTrack-2. At the end of 2002, when renewal license fees were due, New Century asked Positive Software to defer full payment of the renewal fee and to consider alternative billing arrangements. Although Positive Software did not know it at the time, New Century did this in order to continue its use of LoanForce until New Century's replacement product was ready, without having to incur the full annual license fee for LoanForce.

Positive Software, unbeknownst to New Century, was investigating New Century's LoanTrack-1 project and had concluded that LoanTrack-1 was making improper use of Positive Software's intellectual property rights in

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[3] New Century subsequently acquired eConduit.

LoanForce. Positive Software thus began to prepare for litigation with New Century. On January 1, 2003, New Century went into default under the Software Subscription Agreement. On January 6, 2003, Positive Software sent New Century demand for payment. New Century never made the payments required under the Software Subscription Agreement. On February 6, 2003, Positive Software declared the Software Subscription Agreement to be terminated. This litigation soon followed.

2. The Protective Order and Preliminary Injunction. – To protect the parties' confidential information during the pendency of this action, the Court entered a protective order (the "Protective Order"), signed on April 28, 2003. The agreed Protective Order specifically identified the categories of individuals who were entitled to use or disclose confidential information produced in the case and expressly provided, *inter alia,* that no confidential information shall be disclosed to non-attorney employees of the receiving party. Protective Order at 4, ¶ 3 ("No disclosure of Confidential Information documents shall be made to other [non-lawyer] employees.").

The Protective Order specifically prohibited New Century's outside counsel from disclosing Confidential Information to New Century employees. *Id.* at 4, ¶ 5 ("Nothing in this Order shall preclude or impede Outside Counsel's ability to communicate with or advise his or her client based on his or her review and evaluation of Confidential Information produced by the opposing party, *provided* that such communications or advice shall not disclose or reveal such Confidential Information.") (emphasis in original).

On the same day the Protective Order was entered, the Court also entered a Memorandum Order and Opinion granting Positive Software's Motion for Preliminary Injunction ("Preliminary Injunction") enjoining New Century from any use of the LoanForce software, the LoanForce database, LoanTrack-I, LF_Moon, and LTK_Moon.[4] Preliminary Injunction at 17.[5]

3. New Century's Representations That It Would No Longer Use or Possess the LoanForce Software. – New Century represented that the backup tapes and forensic copies of LoanForce would be kept securely in the custody and control of New Century's counsel. Norment Declaration at ¶ 10 (March 7, 2003) ("All these materials have been or will be placed in a temperature controlled, secure location in the custody and control of legal counsel."). In an April 21, 2003 letter to the Court, lead counsel for New Century affirmed:

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[4] The Preliminary Injunction "further ORDERED that New Century delete or return all LoanForce software, including application software and the LoanForce database, that New Century has the ability to access (excepting materials produced in discovery for use in this litigation and/or arbitration)." Preliminary Injunction at 17. However, upon request from Positive Software, that sentence was later vacated. *See* Order (April 29, 2003). Had that language remained in the Preliminary Injunction, this would be a much shorter Order.

[5] On January 15, 2004, after the instant dispute came to light, the Court signed an order clarifying the Protective Order to include within the definition of " confidential information":

> the original and all copies (whether maintained as forensic images, or backup tapes or disks, or any other format, documentary or electronic) of all or any portion of the LoanForce code (both application and database), regardless of how originally acquired, that are in the possession, custody or control of any of the Defendants, any person or entity affiliated with the Defendants, or any employee, contractor, or agent (including attorneys) of Defendants. . . .

- New Century had no intention of ever again using LoanForce application software, the LoanForce database, LoanTrack, LF_Moon, or LTK_Moon.
- New Century would, no later than April 25, 2003 and under Dr. Pooch's supervision, delete or return to [Positive Software] all LoanForce software, including application software and the LoanForce database that New Century has the ability to access.
- New Century would not use LoanTrack-2 for telemarketing or any other commercial purpose before May 12, 2003.

Based on those steps, he further represented that additional injunctive relief requested by Positive Software "is not necessary. New Century, under Dr. Pooch's supervision, has removed any danger of imminent harm to [Positive Software's] legitimate interests."

On April 24, 2003, Dr. Udo Pooch stated that "New Century ceased using LoanTrack-1 and the LoanForce database . . . commencing April 18, 2003." Amended Declaration of Udo Pooch, ¶ 3. According to Dr. Pooch, as of April 18, 2003, "no New Century-Retail IT personnel had access" to the data from the LoanForce database. *Id.* at ¶ 3. Dr. Pooch personally "supervised and observed the deletion of LoanForce, LoanTrack, LTK Moon and LF Moon. This was done following my direction and in my presence. . . ." *Id.* at ¶ 4. Finally, Dr. Pooch affirmed, "[b]ased on my professional opinion, New Century has satisfactorily cleansed itself of LoanForce, LoanTrack, LTK Moon and LF Moon." *Id.* at ¶ 5. These representations were made while the Court was considering the scope of preliminary injunctive relief and were intended to persuade the Court that no further injunctive relief was necessary to protect Positive Software's installed software at New Century's facilities; the representations did in fact affect the Court's decision on that issue.

4. New Century's Continued Use of the LoanForce Software. – Notwithstanding those representations, New Century continued to make use of LoanForce. New Century accidentally produced to Positive Software a copy of an analysis New Century performed of LoanForce and LoanTrack, which precipitated this dispute; New Century never intended to disclose that use and sought return of the accidentally produced document. Following that accidental production, New Century described its use of LoanForce to the Court, characterizing it as minimal. New Century Mortgage's Chief Technology Officer for its Retail Division, John Norment, admitted that he had access to Positive Software's confidential source code in November 2003:

> In November 2003, as part of New Century's trial preparation, and in order to assist New Century's counsel in the case, I created a workbook using Microsoft's Excel spreadsheet program that compared the Loanforce database schema to the database schema for products New Century had created, including the LFMoon database, the LTKMoon database, and the LoanTrack (for LoanTrack-1) database. In doing this work, I used the same database schema for the databases that New Century produced to Positive in this litigation on April 9, 2003. I did not use any material produced in this litigation by Positive.

Norment Declaration at ¶ 4.

In a subsequent letter to the Court, dated January 15, 2004, New Century's lead counsel provided additional information about Norment's access to the Loanforce database:

> [W]e understand that Mr. Norment first obtained access to the compact disks containing [the] LoanForce database on June 16, 2003, when he signed the CD out from the New Century legal department, which was maintaining the CD and the forensic images that had been created under the supervision of Dr. Pooch. Mr. Norment signed the CD back in on July 10, 2003. . . . Mr. Norment may have kept a copy of the CD's contents on his "personal" sector of a New Century server. . . .

In the same letter, lead counsel explained that "Mr. Norment suggested the idea of comparing the code and reporting the results to counsel, and counsel agreed that such a comparison might be useful and directed him to create it for purposes of investigating the facts underlying Positive [Software]'s allegations of copying." These representations substantially understate New Century's actual subsequent use of LoanForce.

*5. **New Century's Actual Conduct.*** – Following the foregoing revelations, the Court authorized discovery into New Century's use of Positive Software's software in the course of this litigation, and held that the attorney-client privilege and work product immunity were waived under the crime-fraud exception. To say that New Century was reticent in providing discovery would be extreme understatement. Following this discovery, a different picture of the facts and New Century's conduct has emerged.

First, contrary to New Century's representations that all of LoanForce had been purged from their computer systems and placed under lock and key in their legal department, it appears that New Century maintained numerous copies of the LoanForce databases in New Century's backups, which could be restored by a simple request to New Century's help desk.[6]

Second, contrary to New Century's representations that Norment merely obtained the forensic copy from the legal department and used it for a month to generate his analysis, it appears that seven or eight different backup copies of the LoanForce database were restored to New Century's servers for analysis. Norment directed Robert Haas to undertake to recreate LoanForce for Norment's use in litigation support activities. Haas obtained no fewer than seven different versions of the LoanForce database from backup tapes and restored them to New Century servers. Some of those servers were available to any New Century employee with general network privileges, including database programmers and architects.[7]

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[6] The Court is not suggesting that it was misled regarding the *existence* of backups. Indeed, preservation of existing backups and images was required by the Court's May 2, 2003 modification of the Preliminary Injunction, made at Positive Software's request. Rather the Court is saying that the subsequent *reinstallation* of the backups was inconsistent with New Century's representation that it had purged its computers of LoanForce. Admittedly, New Century's lead counsel's letter to the Court advising that LoanForce would be purged from New Century's computer systems did not say "and we won't put it back." At the hearing on the contempt motions, New Century's lead counsel appeared to latch onto this possible loophole, stating he believed that New Century's subsequent conduct was consistent with his representations to the Court in his letter. *See* 8/12/04 Trans. at 119. The Court rejects the notion that counsel can properly represent to the Court that his client will implement corrective measures, and therefore no further Court action is required, and then covertly "undo" the corrective measures; that is wholly inconsistent with a lawyer's duty of candor toward the Court. *See, e.g.,* TEX. DISCIPLINARY R. PROF'L CONDUCT 3.03(a)(2), (b).

This project also involved the restoration of the LoanForce application software on the desktop computer of Norment's personal assistant, Alicia Espinoza on December 18-19, 2003, to create a fully-operational LoanForce system (which requires both the database component as well as the desktop application software). Only a week before, on December 11, 2003, Norment testified at deposition that all LoanForce application software had been deleted from New Century's computers. New Century's co-counsel was aware of both Norment's testimony and the subsequent reinstallation of the software on Espinoza's desktop and took no steps to correct Norment's deposition testimony. New Century's co-counsel was also well aware of the scope of Norment's investigation and failed to correct the misleading impression created by New Century's lead counsel's representations to the Court.[8]

Two additional points are worth noting, though they do not directly affect the contempt issues. First, Haas's ability to locate LoanForce materials from New Century's backup media stands in sharp contrast to New Century's representations to the Court of the difficulty involved in locating such materials when Positive Software was seeking them in discovery. Second, during the course of the Norment project, New Century located the script used to create the original LoanForce database delivered to New Century in November 2000. In the arbitration proceeding, Positive Software had consistently sought in discovery the earliest version of LoanForce available, including repeated requests in November and December of 2003. Discovery of the original version was significant because LoanForce evolved after it was delivered to New Century, and apparently Positive Software did not retain a copy in the "as delivered" state. Because New Century did not produce the original version to Positive Software, Positive Software had no opportunity to compare it to LoanTrack-2; instead, Positive Software based its testimony of infringement at the arbitration on a comparison with a version of LoanForce that had been modified by New Century. *The Arbitrator significantly discounted Positive Software's comparison testimony because of this perceived defect. See* Award at 52-53, 79-80, 81-82 ("Given the paucity of evidence in the record respecting the work in which copyright was originally claimed, essentially no material comparisons have been made or can be made. Thus the burden of proof of showing copyright infringement respecting the SQL statements or database schema of the copyrighted work has not been met."). Significantly, Norment advised New Century's co-counsel of the discovery of the November 2000 version in e-mails in December 2003, approximately a month before the arbitration and during the same period Positive Software was repeatedly requesting production of the earliest available version. Amazingly, New Century's co-counsel nonetheless failed to produce the script for the original version of LoanForce.

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[7] Indeed, more recent analysis of electronic discovery suggests that the presence of and access to LoanForce may have been even more pervasive at New Century after April 28, 2003. This would appear to be a difficulty for New Century's "clean room" defense of LoanTrack-2. Because further consideration of the electronic discovery is not material to disposition of the instant motions, the Court will not address it further. New Century's motion to strike such materials is therefore denied as moot.

[8] The record is not clear regarding whether New Century's lead counsel was aware of Norment's activities when they were taking place.

B. New Century's Conduct Violated the Protective Order[9]

The Court first addresses whether New Century's conduct actually violated the Protective Order. The Court conducts this inquiry before it considers whether the Protective Order is sufficiently definite and certain to be enforced by contempt. The Court follows this sequence, rather than the reverse, to ensure that future litigants have a clear understanding of how to follow protective orders such as the one in this case.[10]

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[9] Much of this section is taken from the Court's Order of March 3, 2004.

[10] This is similar to the reason that courts in qualified immunity cases first analyze whether there is an allegation of violation of a constitutional right before considering whether the other elements of immunity are established; to follow the reverse order would result in the contours of constitutional rights never becoming clearly established.

> In the course of determining whether a constitutional right was violated on the premises alleged, a court might find it necessary to set forth principles which will become the basis for a holding that a right is clearly established. This is the process for the law's elaboration from case to case, and it is one reason for our insisting upon turning to the existence or nonexistence of a constitutional right as the first inquiry. The law might be deprived of this explanation were a court simply to skip ahead to the question whether the law clearly established that the officer's conduct was unlawful in the circumstances of the case.

Saucier v. Katz, 533 U.S. 194, 201 (2001); *see also Siegert v. Gilley,* 500 U.S. 226, 232 (1991). Likewise here, the Court intends to ensure that future litigants find similar protective orders to be clear, definite, and free from any ambiguity.

1. The Text of the Protective Order Does Not Authorize New Century's Conduct. – The starting point of this inquiry is the language of the Protective Order.[11] New Century argues that its conduct was proper under two provisions of the Protective Order: (1) the definition of Confidential Information; and (2) the provision excluding a party's own materials from the limitations on use of Confidential Information. The Court finds that neither of those provisions authorizes New Century's conduct.

The language of the Protective Order makes clear that "Confidential Information" includes information, not merely the medium on which the information is found:

> **Confidential Information.** [1] Upon a determination by any party or non-party from whom discovery is sought (the "Designating Party") that any documentation or thing being produced or disclosed, whether formally or informally, including but not limited to [listing various discovery mechanisms], contains a trade secret or other proprietary or business information that the Designating Party would, in the ordinary course of business, not disclose to competitors, the Designating Party may designate such document or thing "Confidential" (collectively, "Confidential Information"). [2] Confidential Information shall include, *inter alia,* any document or thing that the Designating Party believes in good faith constitutes or embodies matter used by it in or pertaining to its business, which matter is not

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[11] When interpreting the terms of a court order, courts should consider the plain meaning of the language and the normal usage of the terms in question. *See, e.g., City of Hartford v. Chase,* 942 F.2d 130, 134 (2d Cir. 1991).

> generally known and that the Designating Party would not normally reveal to third parties or would cause third parties to maintain in confidence. [3] Confidential Information further includes, but is not limited to, technical information such as product design and manufacturing techniques or processing information, trade secrets, formulas, research and development information, customer lists, sales and cost information, and pricing information, license agreements, or information that was generated in connection with, or reveals the content of, licensing negotiations; information that a party has treated as confidential and is not subject to public disclosure; information within the definition of trade secret as set forth in Section 1(4) of the Uniform Trade Secret Act (1985); and any other information that would qualify as Confidential pursuant to Federal Rule of Civil Procedure 26(c) or any other legal standard.

Protective Order at ¶ 1 (bracketed numbers added). The three sentences thus provide:

> [1] A party producing a document or thing containing proprietary information may designate that as "Confidential Information";
>
> [2] "Confidential Information" includes, among other things, the physical document or thing itself containing the proprietary information; and
>
> [3] "Confidential Information" further includes the proprietary information that is contained in the designated physical document or thing.

The first sentence says *how* Confidential Information is designated, and the second and third sentences say *what* Confidential Information includes: both the physical document or thing and the proprietary information embodied in the physical document or thing.

New Century argues that the clause "any documentation or thing being produced or disclosed" in the first sentence limits the definition of Confidential Information to items produced in the course of litigation. This interpretation, however, ignores the language of the second and third sentences of the paragraph, which make clear that "Confidential Information" also includes information contained in the designated document or thing, not just the physical object by which that information was transferred from one party to another. While the first sentence read alone might be unclear regarding whether "Confidential Information" means either the document or thing itself or the information contained in it, that is clarified by the following two sentences: The answer is "both."

When construing the Protective Order as a whole, and not just the clause emphasized by New Century, the Court reads "Confidential Information" to include information, not just the physical object embodying that information (namely, a document or thing produced in the course of litigation). Thus, a more logical reading of the clause in question would be that Confidential Information refers to trade secrets or other proprietary business *information* that would not ordinarily be disclosed to competitors. "Any documentation or thing being produced or disclosed" may, if it qualifies as confidential information, be designated as confidential. But if it is properly so designated, it is the information contained in the document or thing, and not simply the document or thing itself, that is protected.

This is consistent with treatment of Confidential Information elsewhere in the Protective Order. Thus, the Protective Order provides,

> No party, counsel, or other person receiving any document or thing that is designated as "CONFIDENTIAL" in accordance with ¶ 1 of this Order (the "Receiving Party") shall use, disclose, or permit the use or disclosure of any such *Confidential Information* to any other person or entity. . . .

Protective Order at ¶ 3. The prohibition on use or disclosure applies to the *information* in designated materials, not merely the materials themselves. Once Positive Software designated LoanForce as Confidential Information, that designation extended to the proprietary information embodied in LoanForce, regardless whether that information was embodied in the physical copy produced in discovery or the physical copy retained by New Century as a forensic copy supposedly under lock and key in its counsel's office. Thus, the plain language of the Protective Order precludes New Century's conduct.

New Century also argues that its use of Positive Software's Confidential Information is permitted by the clause in the Protective Order that provides: "This Order does not restrict in any manner the use or disclosure by any Designating Party of any information in its own documents and things." Protective Order at ¶ 16. The fact that New Century may have retained a forensic copy of the LoanForce software does not make that "its own documents and things." Moreover, the Court already found that "Positive Software owns the rights to LoanForce and holds valid copyright registrations for LoanForce and its component parts." Order at 5 (April 28, 2003). Furthermore, Positive Software *licensed* its software to New Century for a limited purpose. Under the terms of the licensing agreement, any right to access in the Confidential Code licensed to New Century ended upon termination of the licensing agreement. Software Subscription Agreement at ¶ 12 ("Upon termination of any License hereunder, Customer shall return the Product (and any copies made pursuant to Section 2) and all related documentation to Positive."). As of February 6, 2003, Positive Software terminated the Software Subscription Agreement. See Preliminary Injunction at 4. The Court therefore finds that back-up tapes and forensic copies containing LoanForce clearly do not qualify as New Century's own documents and things for purposes of ¶ 16 of the Protective Order.

2. ***An Order Must Not Be Given an Interpretation That Renders It a Nullity.*** – In addition to being inconsistent with the actual language of the Protective Order, New Century's interpretation would result in the Protective Order having essentially no practical effect. The Court is reluctant to interpret its orders in a manner that renders them a pointless exercise, and the case law supports that reluctance. That is particularly the case when, as here, there is an alternative construction that gives life and effect to the order. And here such an alternate construction need not be implied into the words of the order – the Protective Order itself makes clear that its protection extends not just to the document or thing produced, but also to the proprietary information contained or embodied in that document or thing.

The Fifth Circuit has made clear that it will not interpret "confidential information" in a way that renders a protective order a nullity by construing the term to refer to the medium on which information is stored, rather than the information itself. In *Lyn-Lea Travel Corp. v. American Airlines, Inc.*, Lyn Lea and its counsel appealed a finding by the district court that they had violated "protective orders relating to confidential documents obtained during discovery" by disclosing the information contained in those documents. 283 F.3d 282, 290 (5th Cir. 2002). Seeking to avoid a finding of contempt, Lyn Lea and its counsel argued that the protective orders at issue "merely prohibited disclosure of the confidential documents but did not prohibit disclosure of the contents of such documents." *Id.* at 291. Affirming the contempt finding, the Fifth Circuit held that the protective orders must have precluded the disclosure of the information itself, and not merely the paper on which they were stored. Otherwise, the protective order would have no effect. *Id.* ("Lyn-Lea's reading of the protective orders would render them a nullity.").

Other circuits have likewise reached the conclusion that orders must not be read to render their terms a nullity. *See, e.g., United States v. Greyhound Corp.*, 508 F.2d 529, 533 (7th Cir. 1974) (rejecting "twisted interpretations" of an order that would render a provision of the order a nullity); *First Nat'l Bank & Trust v. Dep't of the Treasury*, 63 F.3d 894, 899 (9th Cir. 1995) ("The Bank admits violating various policies which it had adopted pursuant to the cease and desist order, yet insists it did not violate the cease and desist order. The Bank contends the order required only 'adoption,' not actual implementation, of the policies. Therefore, the Bank reasons, its failure to abide by those policies amounted to just that, a violation of the policies, *not* the terms of the cease and desist order. This argument is without merit. As the Comptroller puts it, 'the Bank's reading would render the cease and desist order meaningless; there is no point in having the Bank adopt a comprehensive revision of its policies and practices if the Bank is not obliged to abide by' them."); *Bancamerica Commer. Corp. v. Mosher Steel,* 100 F.3d 792, 795 (10th Cir. 1996) (rejecting a reading of an EPA order that would render meaningless one of its provisions).

If orders prohibiting the disclosure of confidential information are to have any meaning, they must prohibit disclosure in any form. In *City of Hartford v. Chase,* the parties reached a settlement agreement conditioned on a confidentiality order from the judge prohibiting the disclosure of materials related to the settlement agreement. 942 F.2d 130, 135 (2d Cir. 1991). The Hartford Courant and one of its reporters intervened to vacate the confidentiality order. The district judge ruled that it was unnecessary to vacate the confidentiality order because that order applied only to disclosure of the court file, not materials containing the same information in the city's possession. Disclosure of the city's materials, the district judge reasoned, could be compelled under the Connecticut Freedom of Information Act. Rejecting the district court's interpretation of the Confidentiality Order, the Second Circuit concluded that:

> [t]he district court's interpretation of the Confidentiality Order would also make that order meaningless. If the City has in its possession all the documents that are contained in the court file, and documents in the City's possession are not protected from disclosure, sealing the court file would serve no purpose – the contested material could be obtained simply by requesting it from the City itself. We find it hard to believe

> that the parties would have gone to such great efforts to draft an order with no practical effect.

Id.

In *Grove Fresh Distributors, Inc. v. John Labatt Ltd.*, 888 F. Supp. 1427, 1437 (N.D. Ill. 1995), an Illinois district court faced similar arguments:

> Mr. Messina's primary defense is his assertion that the scope of the orders of confidentiality was so limited that neither the protective order nor the seal prohibited his disclosures. According to Mr. Messina, the protective order prohibited the dissemination of very little. Mr. Messina testified that he did not understand the protective order to prohibit him from revealing the contents of pleadings. Nor from revealing confidential discovery information such as answers to interrogatories nor answers to requests to admit. Nor from disclosing the deposition testimony of witnesses. Nor from disseminating the contents of documents marked "confidential."
>
> Mr. Messina's interpretation of the seal order is similarly cramped. Mr. Messina testified that he did not understand the seal order as preventing him from revealing the contents of depositions under seal, other discovery materials under seal, or quoting verbatim from sealed materials. The only thing that Mr. Messina believed the sealing order actually prohibited was the public disclosure of the actual pleadings – the physical documents themselves – filed in the case.

In rejecting Messina's argument, the *Grove* Court called the view that one may disclose the content of confidential documents but not the physical documents themselves a "tortured" interpretation of the Court's order. *Id.* at 1438 (noting that "[c]ourts are not and should not be compelled to accept 'twisted interpretations' or 'tortured constructions' of an order"). Messina's reading of the order renders it useless. *Id.* (noting that because a court order is issued to be obeyed, "a court should not interpret the order in such a way as to render it a nullity").

Together, *Lyn-Lea, City of Hartford,* and *Grove* stand for the proposition that a court should not read "confidential information" in a protective order in a way that will render the order a nullity. Yet that is precisely what New Century's reading of the Protective Order asks this Court to do. Under New Century's interpretation, the information that receives protection when it is stored on media produced in the course of litigation receives no protection when it is stored on backup tapes or forensic copies.[12] The cited cases reach that result as a matter of construction of the term "confidential information" in a manner to prevent the order in question from being a nullity. The argument against New Century's construction is even stronger in this case, where the Protective Order explicitly provides that a designation as Confidential Information includes not only the document or thing so designated, but also the information contained in that document or thing.

3. Orders Must Be Read in Context with Other Orders. – The Protective Order does not exist in a vacuum, and it should be read in the context of the litigation.[13] New

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[12] Indeed, under New Century's reading, nothing in the Protective Order would prevent posting the source code for LoanForce on the Internet, so long as it was copied from the backup tapes, rather than media produced in the course of litigation.

[13] In one of its briefs, New Century cites *Riccard v. Prudential Ins. Co.,* 307 F.3d 1277, 1296 (11th Cir. 2002), for the proposition that courts

(Continued on following page)

Century's interpretation of the Protective Order would conflict with other orders in effect at the time. On April 28, 2003, this Court signed a Preliminary Injunction enjoining New Century and any person acting in active concert with it "from any use of the LoanForce software, the LoanForce database, Loan-Track-I, LF_Moon, and LTK_Moon." Preliminary Injunction at 16-17. The Court made clear that the purpose of the Preliminary Injunction was to enforce the terms of the Software Subscription Agreement and enjoin any further misappropriation of Positive Software's confidential information. *Id.* at 4 n.4 ("Positive Software requests relief to enforce the terms of the Software Subscription Agreement, enjoin further misappropriation of its confidential information, and preserve the status quo between the parties pending arbitration. The issuance of a preliminary injunction, thus, is proper."). The Software Subscription Agreement makes clear that upon termination of the Subscription Agreement, any continued use of Positive Software's software is prohibited. ("[U]pon termination of this Agreement, Customer agrees to return to Positive, or promptly destroy at the direction of Positive, at any time upon request of Positive for any reason, any other Confidential Information, including any source of electronic information and all records, notes, documents, drawings, prototypes, specifications, programs, data, devices and other materials containing or pertaining to any Confidential Information." Software

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must give their orders a "reasonable interpretation." New Century's Opposition to Positive Software's Motion for Contempt at 6. In determining whether an interpretation is reasonable, the *Riccard* Court emphasizes that "[c]ontext is often important to meaning, and so it is here." *Id.* at 1297.

Subscription Agreement at ¶ 7(D).[14] As of February 6, 2003, Positive Software terminated the Software Subscription Agreement. *See* Preliminary Injunction at 4.

Together with the Protective Order, these documents demonstrate that the clear intent of the Court and the parties was to prevent those making allegedly infringing and competing software from using or copying LoanForce. Taken in this context, New Century's construction of the Protective Order is not viable.

4. An Order Requires Less Specificity When It Is Written for Lawyers. – New Century's interpretation is even less reasonable because the audience was not laypersons, but lawyers. An order requires less specificity when the audience is a member of the bar. *Grove,* 888 F. Supp. at 1438 ("When the audience is a member of the bar, that fact will be taken into account in determining reasonable specificity, and orders that would otherwise require greater specificity for a layperson will require less for a lawyer.").

As Positive Software points out in its brief, the audience for the Protective Order at issue in this case is a publicly traded corporation with an in-house legal department, represented by a well-regarded law firm. Moreover, the allegedly infringing conduct took place at the direction and with the consent of New Century's counsel. *See, e.g.,* New Century Letter (January 15, 2004) ("Mr. Norment suggested the idea of comparing the code and reporting the results to counsel, and counsel agreed that such a comparison might be useful and directed him to create it for purposes of investigating the facts underlying Positive [Software]'s allegations of copying."). Thus while a layperson might not be familiar with the distinction in intellectual property law between the tangible medium containing information and the information itself, New Century is hard pressed to profess such ignorance.

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[14] In the Software Subscription Agreement, "Confidential Information" is a defined term, with a definition that is not the same as that in the Protective Order.

The Court therefore finds that Positive Software has shown by clear and convincing evidence that New Century violated the Protective Order.

C. The Protective Order Is Arguably Not Sufficiently Definite

The Court must now address New Century's contention that the Protective Order cannot be enforced by contempt because it is not sufficiently definite. Several of New Century's arguments appear to go to its state of mind, i.e., it had a good faith belief that the Protective Order should be read to apply only to documents produced by Positive Software in discovery.[15] The Court declines to consider those arguments for two reasons. First, in civil contempt state of mind is not a consideration. "In a civil contempt proceeding, the party seeking an order of contempt need only establish (1) that a court order was in effect, and (2) that the order required certain conduct by the respondent, and (3) that the respondent failed to comply with the court's order." *FDIC v. LeGrand,* 43 F.3d 163, 170 (5th Cir. 1995) (citing *Martin v. Trinity Industries, Inc.,* 959 F.2d 45, 47 (5th Cir.1992)). "Intent is not an issue in civil contempt proceedings; rather, the question is whether the alleged contemnors have complied with the court's order." *Whitfield v. Pennington,* 832 F.2d 909, 913 (5th Cir. 1987) (citing *Jim Walter Resources v. Int'l Union, United Mine Workers,* 609 F.2d 165, 168 (5th Cir. 1980)). Second, determining whether an order is sufficiently definite to be enforced by contempt is a question of law for the Court. *See Martin v. Trinity Indus. Inc.,* 959 F.2d 45, 47 (5th Cir. 1992) (reviewing issue de novo); *cf. Instone Travel Tech Marine & Offshore v. Int'l Shipping Partners, Inc.,* 334 F.3d 423, 431 (5th Cir. 2003) (whether contract is ambiguous is question of law for the court). Accordingly, the Court need not, and does not, determine whether New Century or its counsel acted in good faith.

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[15] For example, New Century offers the Declaration of Michael O'Neil, indicating that orders such as the Protective Order are not typically construed to cover documents other than those produced in discovery.

The Court now considers whether the Protective Order was sufficiently definite for New Century's violation to be punished by contempt. "Contempt is committed only if a person violates a court order requiring in specific and definite language that a person do or refrain from doing an act. The judicial contempt power is a potent weapon which should not be used if the court's order upon which the contempt was founded is vague or ambiguous." *Martin, supra,* 959 F.2d at 47 (internal quotations and citations omitted). *Accord Piggly Wiggly Clarksville, Inc. v. Mrs. Baird's Bakeries,* 177 F.3d 380, 382-83 (5th Cir. 1999).

As indicated above, the Court believes the Protective Order has a definite meaning, and in that sense it is not ambiguous. However, there are characteristics of the language that perhaps do not provide specific and definite language requiring New Century to refrain from making litigation-related use of its backup copies of LoanForce. First, the Protective Order facially relates to materials produced in discovery; although the Court holds that it applies to the informational content, as well as the physical copy, a party might not have read it that way without the benefit of the Court's analysis above. Second, the Protective Order also expressly does not restrict a party's use of its own documents; again, although the Court holds that language does not permit New Century free use of the backup copies of LoanForce, a party might not have read it that way without the benefit of the Court's analysis above. Third, relief relating to copies of the software properly obtained during the pendency of the business relationship, which was one of Positive Software's substantive claims for relief, might reasonably be expected to be in the preliminary injunction, which related to relief on the merits, rather than in the protective order, which primarily related to discovery. Fourth, the Protective Order did not expressly state in so many words that a designation of materials as confidential also applied to copies of the designated materials already in the possession of the receiving party.

D. Conclusion on Contempt

The Court, with considerable reluctance, holds that the Protective Order was not sufficiently clear and definite to be enforced by contempt. The Court's reluctance arises from the Court's view that New Century's conduct was not appropriate. The reluctance is heightened by the Court's conviction that New Century knew that if the Court or Positive Software were aware of New Century's conduct, it would be expressly prohibited. And the conduct was not already expressly prohibited only because New Century represented that such prohibition was unneeded. New Century thus created a loophole, and then covertly took advantage of it. Although the Court has held that New Century's conduct was prohibited by the Protective Order, New Century has successfully muddied the waters to an extent that contempt for violation of the Protective Order is not available.

The Court must note two more concerns. First, the Court is distressed that New Century's lead counsel represented to the Court that New Century would take certain steps and, therefore, that Positive Software did not need further relief from the Court, and then once the Court denied additional relief, New Century did exactly the opposite of what it represented. While the Court is most unhappy at being misled, that is not a basis for contempt for violation of either the Protective Order or the Preliminary Injunction – the grounds raised by Positive Software in its motions. The Court is skeptical that New Century's lead counsel did not know what co-counsel was doing with Norment, and that co-counsel did not know what lead counsel had represented to the Court. Absent that double-ignorance, counsel should have *at minimum* notified the Court that the prior representations were no longer correct.

Second, the Court is most distressed that New Century did not timely produce the November 2000 SQL script. This is not simply a case of the document not being found in time to produce. It was found in time, about a month before the arbitration, and New Century so advised its co-counsel – at or about the same time Positive Software was reiterating its request for the earliest version of the database that New Century had. New Century simply did not produce it, and offers no explanation for that failure. But discovery abuse is likewise not a basis for contempt; in this case, moreover, the discovery was proceeding under the supervision of the arbitrator, not the Court, and thus is beyond the reach of Rule 37. The Court's lack of response in this case to New Century's failure to produce the November 2000 script should not be taken as approval.

Accordingly, Positive Software's motion for contempt is denied.[16]

II. THE ARBITRATOR'S FAILURE TO DISCLOSE HIS PRIOR RELATIONSHIP WITH NEW CENTURY'S COUNSEL GIVES RISE TO AN APPEARANCE OF PARTIALITY THAT REQUIRES VACATING THE AWARD

Following the Award, Positive Software became aware, for the first time, that the Arbitrator had a prior relationship with New Century's counsel. The Arbitrator served as co-counsel with New Century's counsel over a period of years in significant litigation. Although the Arbitrator was required to disclose that relationship under AAA rules, he never disclosed it. In Positive Software's view, this prior relationship explains the Arbitrator's evident distaste for Positive Software's position. The Court need not reach that question, however. The Court holds that the Arbitrator's prior relationship "might create an impression of possible bias." *Commonwealth Coatings*

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[16] New Century's motion for contempt and Positive Software's second motion for contempt are likewise denied. Positive Software's motion, to the extent it is based on violation of the Preliminary Injunction, is denied because the court does not construe the prohibition on "use" of the software to include use of the software incidental to New Century's defense of this action.

Corp. v. Continental Cas. Co., 393 U.S. 145, 149 (1968). Accordingly, the Arbitrator's failure to disclose that relationship deprived Positive Software of the opportunity to make an informed choice of arbitrators and requires vacatur of the award.

A. *Factual Background*

1. The Intel Litigation. – Intel Corporation and Cyrix Corporation were involved in protracted patent litigation for seven years in the 1990s (the "Intel Litigation").[17] The litigation began in 1990, *see Cyrix Corp. v. Intel Corp.,* 803 F. Supp. 1200 (E.D. Tex. 1992) (reflecting Cause No. 4:90CV264), and lasted until April 26, 1996, when rehearing was denied. *See Cyrix Corp. v. Intel Corp.,* 77 F.3d 1381 (Fed. Cir. 1996). It appears that New Century's outside law firm in this matter ("SG Law Firm") and the Arbitrator's law firm ("AWD Law Firm") represented Intel as co-counsel from the beginning of the action. *See* 803 F. Supp. at 1202. Indeed, New Century's co-counsel in this case appeared for Intel early in the litigation. *See id.*

The Arbitrator began representing Intel in the Intel Litigation in September 1992. New Century claims that co-counsel's personal involvement in the case ended in approximately July 1992, before the Arbitrator's involvement in the case began. However, co-counsel's name continues to appear with the Arbitrator's name on pleadings as late as June 1993. *See, e.g., Intel's Opposition to Cyrix's Motion to Preclude Intel from Referring to the Presumption of Validity in the Presence of the Jury,* filed January 19, 1993; *Intel's Supplemental Opposition to*

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[17] The Intel Litigation involved five related lawsuits.

Cyrix's Motion to Set the Order of Trial, filed June 15, 1993; *see also Intel's Notice of Appeal* to the Federal Circuit on September 19, 1993 (bearing co-counsel's name and AWD Law Firm, but not the Arbitrator personally). Moreover, Court opinions still reflect New Century's co-counsel personally as one of the counsel for Intel, together with AWD Law Firm, as late as 1995. *See Cyrix Corp. v. Intel Corp.*, 879 F. Supp. 672, 673 (E.D. Tex. 1995). Apparently, New Century does not deny the Arbitrator's past relationship with SG Law Firm and other SG Law Firm lawyers who all served as co-counsel for Intel in the Intel Litigation.

2. The Arbitrator's Failure to Disclose the Prior Relationship. – Arbitration of this matter took place under the auspices of the American Arbitration Association ("AAA"). Pursuant to AAA procedures, AAA gave the parties a list of candidate arbitrators, including the Arbitrator, and asked them to rank the candidates. New Century's counsel did not disclose their prior relationship with the Arbitrator. After AAA eliminated candidates who were objectionable, the Arbitrator was the highest ranked candidate and he became the presumptive arbitrator.[18] Had Positive Software been aware of the Arbitrator's prior relationship with New Century's co-counsel and with SG Law Firm, co-counsel's law firm, Positive Software would not have ranked the Arbitrator so highly, and he would not have become the arbitrator in this matter.

On June 18, 2003, AAA wrote the Arbitrator to determine his availability to serve; AAA's letter explicitly disclosed that SG Law Firm and, in particular, New Century's co-counsel, represented New Century in the pending arbitration. At the bottom of the letter appeared the following:

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[18] There were other steps in the selection process not material to this decision.

> * * * * **IMPORTANT REMINDER** * * * *
>
> Please remember, ***your obligation to disclose any circumstance likely to affect impartiality or create an appearance of partiality is ongoing*** Should you become aware of a new or additional disclosure, please notify your case manager immediately[.] (emphasis in original).

On June 23, 2003, the AAA confirmed the Arbitrator's agreement to serve as the sole arbitrator. The AAA informed the Arbitrator that the case "will be administered under the Association's Commercial Dispute Resolution Procedures as amended and in effect January 1, 2003," and directed him to their location on the internet. The Arbitrator also received written copies of the Rules, the Guide for Commercial Arbitrators, and the Code of Ethics. The confirmation also included a Notice of Appointment Form and the Arbitrator's Oath. The bottom of the confirmation letter contained the same "important reminder" regarding the Arbitrator's duty to disclose.

On the same day he received the AAA's confirmation of his appointment, the Arbitrator mailed in his acceptance. In that letter, he stated, "Enclosed is the completed ***Arbitration Disclosure Form*** indicating that I have nothing to disclosed [sic] in view of the . . . attorneys . . . identified in the materials you sent me under cover of your June 18 letter."

In addition to the letter, the Arbitrator provided a completed Notice of Appointment form that included questions "designed to help you decide if you have something to disclose." One of the twelve questions was: "Have you had any professional or social relationship with counsel for any party in this proceeding or the firms for which they work?" The Arbitrator indicated, "I have nothing to disclose." The top of the Notice of Appointment contains a boxed statement:

> It is most important that the parties have complete confidence in the arbitrator's impartiality. Therefore, please disclose any past or present relationship with the parties, their counsel, or potential witnesses, direct or indirect, whether financial, professional, social or of any other kind. . . . Any doubts should be resolved in favor of disclosure. If you are aware of direct or indirect contact with such individuals, please describe it below. The AAA will call the facts to the attention of the parties' counsel.

Just below the boxed statement is the following: "If you are able to accept this responsibility as Arbitrator, please sign and return this form to the AAA." The Arbitrator signed the form, expressly affirming that "the panel biography provided by the American Arbitration Association is accurate and complete." At no time before, during, or after the arbitration did the Arbitrator disclose his prior relationship with SG Law Firm or New Century's co-counsel. Positive Software represents that it did not become aware of this relationship until it did additional background investigation on the Arbitrator following the award in an attempt to understand a result that it did not believe was consistent with the record.

B. *In a Nondisclosure Case, Vacatur Is Required Where the Facts Support a Reasonable Impression of Partiality*

1. The Supreme Court's* Commonwealth Coatings *Decision. – The United States Arbitration Act authorizes vacatur of an arbitration award "where there was evident partiality . . . in the arbitrators." 9 U.S.C. § 10. Interpreting that provision in favor of broad disclosure, the Supreme Court adopted "the simple requirement that arbitrators disclose to the parties any dealings that *might* create an *impression* of *possible* bias." *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 149 (1968) (emphasis added). The standard of *Commonwealth Coatings* finds support in many of the policies underlying arbitration.

First, the high deference given to an arbitrator's rulings[19] demands a high standard of impartiality. Congress desired "to provide not merely for *any* arbitration but for an impartial one." *Commonwealth Coatings,* 393 U.S. at 147. Accordingly, "we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review." *Id.* at 149.

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[19] It is well-established that review of an arbitration award itself is "exceedingly deferential." *Brabham v. A.G. Edwards & Sons, Inc.*, 376 F.3d 377, 380 (5th Cir. 2004). The Fifth Circuit observed:

> [E]stablished rules of deference foreclose all but the most limited review. Arbitrators need not give reasons for their awards. Even when arbitrators do provide a rationale for their awards, courts may not review that reasoning. Uncertainty about arbitrators' reasoning cannot justify vacatur, for a court must resolve all doubts in favor of arbitration.

Id. at 385 (citations omitted).

Second, a policy of full disclosure increases faith in the arbitration system by assuring the parties that they are aware of all relevant facts in the selection of the arbitrator. Inability to rely on the impartiality of the arbitrator frustrates the federal policy favoring arbitration and jeopardizes its continued use as an alternative method of dispute resolution. *See id.* at 150 ("We cannot believe that it was the purpose of Congress to authorize litigants to submit their cases and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another."); *see also* AAA Notice of Appointment ("It is most important that the parties have complete confidence in the arbitrator's impartiality. Therefore, please disclose any past or present relationship with the parties, their counsel, or potential witnesses, direct or indirect, whether financial, professional, social or of any other kind.").

Third, the Supreme Court's holding in *Commonwealth Coatings* reflects its judgment that the parties, rather than arbitrators or courts, are in the best position to ensure the selection of an impartial arbitrator. Arbitrators may have incentives not to disclose all potentially problematic relationships voluntarily. A rule favoring full disclosure protects both the arbitrator and the parties: "In many cases the arbitrator might believe the business relationship to be so insubstantial that to make a point of revealing it would suggest he is indeed easily swayed, and perhaps a partisan of that party. But if the law requires the disclosure, no such imputation can arise." *Id.* at 151 (White, J., concurring).

Similarly, the parties are in a better position than courts to judge the impartiality of the arbitrator. "The judiciary should minimize its role in arbitration as judge of the arbitrator's impartiality. That role is best consigned to the parties, who are the architects of their own arbitration process, and are far better informed of the prevailing ethical standards and reputations within their business." *Id.* A rule favoring full disclosure minimizes the court's role in determining the impartiality of the arbitrator. *Id.* at 152 ("If arbitrators err on the side of disclosure, as they should, it will not be difficult for courts to identify those undisclosed relationships which are too insubstantial to warrant vacating an award.").

In the final paragraph of the majority opinion, the Court emphasizes that "any tribunal permitted by law to try cases and controversies not only must be unbiased but also must avoid even the appearance of bias." *Id.* at 150. This full disclosure has been incorporated by the AAA, which provides arbitrators with multiple reminders of their "obligation to disclose any circumstance likely to affect impartiality or create an *appearance of partiality.*" (emphasis added).

2. "Evident Partiality" in Nondisclosure Cases. – After *Commonwealth Coatings,* the Fifth Circuit has not "definitively addressed" the standard for evident partiality. *Mantle v. Upper Deck Co.,* 956 F. Supp. 719, 728 (N.D. Tex. 1997). Other circuits have developed two different standards for evident partiality, one for nondisclosure cases, and one for other claims of bias. In nondisclosure cases, courts have adopted a more lenient "reasonable impression of partiality" standard. *See, e.g., Schmitz v. Zilveti,* 20 F.3d 1043, 1049 (9th Cir. 1994); *Al-Harbi v. Citibank, NA.,* 85 F.3d 680, 683 (D.C. Cir. 1996); *Olson v. Merrill Lynch,* *Pierce, Fenner & Smith,* 51 F.3d 157, 159-60 (8th Cir. 1995); *Middlesex Mutual Ins. Co. v. Levine,* 675 F.2d 1197, 1200 (11th Cir. 1982). Cases not involving nondisclosure use a more strict standard for evident partiality. In *Morelite Construction Corporation v. New York City District Council Carpenters Benefit Funds,* 748 F.2d 79 (2d Cir. 1984), the court concluded that an arbitrator is "evidently partial" only where the circumstances were such that a "reasonable person would have to conclude that [the] arbitrator was partial to one party to the arbitration." *Id.* at 84. *Accord Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.,* 991 F.2d 141, 146 (4th Cir. 1993)[20]; *Health Services Mgmt. Corp. v. Hughes,* 975 F.2d 1253, 1264 (7th Cir. 1992); *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344, 1358 (6th Cir. 1989).[21]

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[20] *Peoples Security* is somewhat different in that it involved an attorney for a litigant joining a different office of the arbitrator's law firm after the arbitrator had been selected. Because *People Security* did not involve a failure to disclose a prior relationship before selection of the arbitrator, it does not seem to fit in the nondisclosure category.

[21] At least one court has not considered these to be different standards applicable in different circumstances, but rather two conflicting standards adopted by different courts in the wake of *Commonwealth Coatings*:

> Although Justices White and Marshall joined fully in Justice Black's opinion for the Court, some lower federal courts have purported to see a conflict between the two writings. By treating Justice Black's opinion as a mere plurality, they have felt free to reject the suggestion that "evident partiality" is met by an "appearance of bias," and to apply a much narrower standard.
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> For example, in *Morelite Construction Corporation v. New York City District Council Carpenters Benefit Funds,* 748 F.2d 79 (2d Cir. 1984), the court expressly referred to Justice Black's opinion as one for a plurality of four justices. *Id.* at 82. Working "on a relatively clean slate," the court

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reasoned that parties agree to arbitrate precisely because they prefer a panel with expertise regarding the subject matter of the dispute. *Id.* at 83. Because this expertise often comes through experience in the field, which may have involved personal dealings with the parties, the court concluded that something more than an "appearance of bias" was necessary to disqualify an arbitrator. *Id.* at 83-84. "To disqualify any arbitrator who had professional dealings with one of the parties (to say nothing of a social acquaintanceship) would make it impossible, in some circumstances, to find a qualified arbitrator at all." *Id.* at 83. Balancing the competing goals of expertise and impartiality, the court concluded that an arbitrator is "evidently partial" only where the circumstances were such that a "reasonable person *would have to conclude* that [the] arbitrator was partial to one party to the arbitration." *Id.* at 84 (emphasis added).

At least three other federal circuits have also adopted an "evident partiality" standard. *See Peoples Security Life Ins. Co. v. Monumental Life Ins. Co.*, 991 F.2d 141, 146 (4th Cir. 1993) (adopting the *Morelite* standard); *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344, 1358 (6th Cir. 1989) (same); *Health Services Management Corp. v. Hughes*, 975 F.2d 1253, 1264 (7th Cir. 1992) (holding that the alleged conflict "must be so intimate . . . as to cast serious doubt on the arbitrator's impartiality," and further holding that the interest or bias "must be direct, definite and capable of demonstration rather than remote, uncertain or speculative").

In contrast, other federal courts, focusing on the need for full disclosure to parties who are choosing their own arbitrators, have adopted a broader standard. For example, in *Schmitz v. Zilveti*, 20 F.3d 1043, 1049 (9th Cir. 1994), the court held that an arbitrator had a duty to disclose that his law firm had represented the parent company of an arbitrating party. The court reasoned that "parties can choose their arbitrators intelligently only when facts showing potential partiality are disclosed." *Id.* at 1047. Concluding that *Commonwealth Coatings* was controlling precedent, the court decided that the "best expression" of the Supreme Court's holding is that evident partiality is present when "undisclosed facts show a reasonable impression of partiality." *Id.* at 1046. This standard, of course, is much broader than that articulated in *Morelite,* as circumstances can

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Application of a more lenient standard in nondisclosure cases is appropriate for several reasons. First, it is consistent with *Commonwealth Coatings.* "Finding a 'reasonable impression' of partiality is not equivalent to, nor does it imply, a finding of actual bias. Otherwise, the *Commonwealth Coatings* court could not have held that a reasonable impression of partiality was present when no actual bias was shown." *Schmitz,* 20 F.3d at 1047. Second, it is consistent with the policies of the Federal Arbitration Act:

> The policies of 9 U.S.C. § 10 also support the notion that the standard for nondisclosure cases should differ from that used in actual bias cases. In a nondisclosure case, the integrity of the process by which arbitrators are chosen is at issue.

> convey an *impression of* partiality without necessarily dictating a *conclusion* of partiality, as required under *Morelite. See also Middlesex Mutual Ins. Co. v. Levine,* 675 F.2d 1197, 1200 (11th Cir. 1982) (adopting "reasonable impression of possible bias" standard, and holding that arbitrator had a duty to disclose that he was involved in an ongoing legal dispute with an insurer party); *Olson v. Merrill Lynch, Pierce, Fenner & Smith,* 51 F.3d 157, 159-60 (8th Cir. 1995) (recognizing that disclosure of "even indirect ties" will aid the arbitration process, and holding that arbitrator was under a duty to disclose business relationship between his firm and party); *Al-Harbi v. Citibank, N.A.,* 85 F.3d 680, 683 (D.C. Cir. 1996) (recognizing arbitrator's duty to disclose facts which "might create an impression of possible bias").

Burlington N.R.R. v. TUCO, 960 S.W.2d 629, 634 (Tex. 1997). *See id.* at 636 (holding "that a prospective neutral arbitrator selected by the parties or their representatives exhibits evident partiality if he or she does not disclose facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality. We emphasize that this evident partiality is established from the *nondisclosure itself,* regardless of whether the nondisclosed information necessarily establishes partiality or bias.") (emphasis in original).

> Showing a "reasonable impression of partiality" is sufficient in a nondisclosure case because the policy of section 10(a)(2) instructs that the parties should choose their arbitrators intelligently. *Commonwealth Coatings,* 393 U.S. at 151 (White, J., concurring). The parties can choose their arbitrators intelligently only when facts showing potential partiality are disclosed. Whether the arbitrators' decision itself is faulty is not necessarily relevant. But in an actual bias determination, the integrity of the arbitrators' decision is directly at issue. That a reasonable impression of partiality is present does not mean the arbitration award was the product of impropriety.

Id. at 1047.[22] Finally, the fact of the nondisclosure itself may create an appearance of bias, even when the underlying facts themselves would not support a finding of actual bias. *See Burlington, supra,* 960 S.W.2d at 636.

In view of this distinction, the line of cases adopting the heightened actual bias standard from *Morelite*, 748 F.2d 79 (2d Cir. 1984), which was not a nondisclosure case, is inapposite. The concern in actual bias cases is that absent a clear and direct showing of actual bias, the most qualified arbitrators, who are likely to have the broadest business experience, will frequently be disqualified because of their previous experience with parties.

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[22] Even one of the cases that New Century cites for a heightened conclusion of partiality standard, recognizes the distinction between nondisclosure cases and ordinary bias cases. *Mantle v. Upper Deck Co.*, 956 F. Supp. 728-29 (N.D. Tex. 1997) (noting that for most courts the heightened actual bias standard applies "where non-disclosure is not alleged").

The question here is not whether the Arbitrator's co-counsel relationship with SG Law Firm, New Century's co-counsel, and others actually biased his decision, but whether the parties had a right to have those facts disclosed at the outset. The nondisclosure cases insist the parties do have that right and that it is an essential part of making an intelligent selection. The actual bias cases set the bar for what kind of information, if disclosed, would be sufficient to vacate an arbitration award on the basis of partiality toward one side. Thus, the Courts of Appeals have articulated two different standards designed to promote two different goals: while a higher threshold for showing actual bias ensures arbitrators with broad experience are not easily disqualified, a demanding full disclosure rule ensures that the parties have the information they need to make an intelligent selection.

3. Promoting Disclosure Is Consistent with the Parties' Expectations. – Additionally, the full disclosure rule of *Commonwealth Coatings* reinforces the parties' expectations that arbitrators will abide by the Rules of the American Arbitration Association (and related rules), which the Supreme Court deemed "highly significant." 393 U.S. at 149. The following AAA rules and guidelines echo the full disclosure principles and at times borrow the language of *Commonwealth Coatings*:

1. AAA, Code of Ethics for Arbitrators in Commercial Disputes, provides in relevant part:

> Persons who are requested to serve as arbitrators should, before accepting, disclose . . . any existing or ***past*** financial, ***business, professional,*** family, or social ***relationships*** which are likely to affect impartiality or which might reasonably create an appearance of partiality or

bias. Persons requested to serve as arbitrators should ***disclose any such relationships*** which they personally have ***with any party or its lawyer*** . . . (emphasis added).

2. AAA, Disclosure and Challenge of an Arbitrator, provides in relevant part:

    Q. Are arbitrators obligated to make disclosures?

    A. Arbitrators ***must*** disclose ***any relationship*** between themselves and a party representative, or a witness. The AAA's rules require that neutral arbitrators be impartial, and that the parties have confidence in their impartiality. The rules require every neutral arbitrator "to disclose to the AAA any circumstances likely to affect his or her impartiality, including any bias or any financial or personal interest in the result of the arbitration or ***any past*** or present ***relationship with the parties or their representatives***." This is also dealt with in the AAA's Code of Ethics for Commercial Arbitrators.

    . . .

    Q. Are there any general principles regarding disclosures?

    A. Yes. They are as follows:

    1. ***Every disclosure, no matter how insignificant should be communicated to the parties.***

    2. If information received from the arbitrator or another source seems vague or incomplete, further inquiries should be made to gather pertinent facts for transmittal to the parties.

. . .

Q. Do I need to disclose prior arbitrations or contact with the law firms involved or only with counsel on the current case?

A. ***All contact with the firm or parties involved shall be disclosed.***

. . .

Q. Can the final award be vacated if the arbitrator fails to make a disclosure?

A. As guidelines for the exercise of arbitrator discretion in this area, the following circumstances were ***deemed sufficient by the courts to require vacature*** of the award on the ground *of* ***partiality***: . . .

5. ***Arbitrator had a case in which the arbitrator was a party or counsel before [with] one who is now a party or counsel*** (emphasis added).

3. AAA, Guide to Commercial Arbitrators, provides in relevant part:

> If you discover, upon being asked to serve, some prior or present business connection with one of the parties and the contact is so close as to be disqualifying, you should decline to serve. Not every business relationship casts doubt on an arbitrator's impartiality. Often, it is enough for an arbitrator to disclose the connection before accepting the appointment. Arbitrators are advised, whenever a question as to such potentially disqualifying information arises, to ***err in favor of disclosing it to the parties.***

> When parties and their witnesses assemble in the hearing room, you might recall for the first time an association with a person involved. ***Prompt disclosure gives the parties an opportunity to waive their objections.*** Such a waiver will bar any subsequent objection to the award on grounds of bias.

It is clear from these rules that arbitrators are expected by the AAA as well as the parties to provide extremely broad disclosure, certainly including serving as co-counsel with one of the party's law firms and, more specifically, one of the party's lawyers. These rules further illustrate that following the broad disclosure principles of *Commonwealth Coatings* will reinforce rather than upset the existing expectations of the parties.

C. A Reasonable Impression of Partiality Exists in This Case

In view of *Commonwealth Coatings* and its progeny, the Court concludes that in nondisclosure cases, an arbitration award must be vacated where there is a reasonable impression of partiality. One way to assess whether undisclosed facts convey a reasonable impression of partiality is to inquire whether those facts would be material to a lawyer selecting an arbitrator, i.e., would a reasonable lawyer in Positive Software's position have wanted to know about the Arbitrator's role in the Intel Litigation before selecting an arbitrator. The answer to that question is clearly yes. Given the contentious nature of this dispute, the duration and importance of the Intel Litigation, and the fact that the arbitration was to be decided by a single arbitrator, the Court is of the firm conviction that any reasonable trial lawyer would want to know of an arbitrator-candidate's prior association with opposing counsel before choosing him as the sole arbitrator. Accordingly, the nondisclosure of that information creates a reasonable impression of partiality.

Alternatively, the Court will consider directly whether the failure to disclose the prior relationship between the Arbitrator and New Century's counsel "might create an impression of possible bias." *Commonwealth Coatings,* 393 U.S. at 149. Here the prior relationship was an extensive one, extending over years in high profile litigation. It involved not just the two law firms working together, it personally involved the Arbitrator and New Century's co-counsel. And even if New Century is correct that its co-counsel quit working on the Intel Litigation before the Arbitrator began working on it, co-counsel's name remained on the pleadings and in court records for years after that; that fact alone is significant to the extent the appearance of impropriety is the issue. The relationship between the two law firms was even more extensive. Finally, because the AAA rules plainly required disclosure of that prior relationship, the nondisclosure in violation of AAA rules heightens the inference of concealment and the appearance of impropriety. Under all these circumstances, the Court holds that the nondisclosure of the prior relationship creates a reasonable impression of partiality.

Nevertheless, New Century suggests two reasons why the Court should find in its favor. First, New Century claims that Positive Software waived its nondisclosure objection by failing to raise it during the arbitration. "Although it is true that a disgruntled party cannot object after an award has been made, *Cook Industries, Inc. v. C. Itoh & Co.,* 449 F.2d 106 (2d Cir. 1971), *cert. denied*, 405 U.S. 921, 30 L. Ed. 2d 792, 92 S. Ct. 957 (1972), this rule applies only where the party has actual knowledge of the facts that form the basis of the objection, *see Middlesex Mutual Ins. Co. v. Levine,* 675 F.2d 1197 (11th Cir. 1982)." *Morelite,* 748 F.2d at 84. Here, Positive Software did not learn those facts until after the arbitration. Accordingly, it did not waive its objection.

Second, although New Century does not expressly claim that the Arbitrator did not remember that SG Law Firm and New Century's co-counsel served with him as co-counsel in the Intel Litigation, New Century hints that perhaps he just forgot. The Court finds that claim factually improbable and legally irrelevant. As the *Schmitz* Court noted,

> [A] reasonable impression of partiality can form when an actual conflict of interest exists and the lawyer has constructive knowledge of it. That the lawyer forgot to run a conflict check or had forgotten that he had previously represented the party is not an excuse. Also, an arbitrator may not know facts of which he may have been suspicious or of which he was on notice which, if true, would create a reasonable impression of partiality if not investigated and disclosed. Requiring arbitrators to make investigations in certain circumstances gives arbitrators an incentive to be forthright with the parties, honestly disclosing what arbitrators might otherwise have an incentive to hide. *Commonwealth Coatings* establishes that the parties rather than the arbitrators or the courts should be the judges of the partiality of arbitrators.
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> . . .
>
> If the parties are to be judges of the arbitrators' partiality, duties to investigate and disclose

> conflicts must be enforced, even if later a court finds that no actual bias was present. We therefore decline to adopt a per se rule that no reasonable impression of partiality can be found absent a showing that the arbitrator knew the facts on which it is based.

20 F.3d at 1048-49 (internal citations omitted). A full disclosure rule is rendered toothless if the corresponding duty to investigate is not enforced. Prospective arbitrators must not be permitted to turn a blind eye toward potentially problematic conflicts of interest. Here, the Arbitrator had ample, even redundant, notice of his duty to investigate any prior co-counsel relationships with SG Law Firm and New Century's co-counsel. The Court therefore finds at minimum he had constructive knowledge of those relationships, and his failure to disclose them raises a reasonable impression of partiality.[23] Positive Software's

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[23] The importance of disclosure here is amplified by Positive Software's claims that the Arbitrator was actually biased. On virtually every close issue, he decided against Positive Software. Some of those decisions appear to the Court to be questionable, though the Court need not decide on this occasion whether they were a manifest disregard of the law. Moreover, the tone of the Award reflects negative feelings towards Positive Software's claims. *See* Award at 7, 35, 46. Had the arbitrator disclosed his role in the Intel Litigation, and the parties agreed to go forward, Positive Software's arguments about actual bias might seem more like "sour grapes." However, the nondisclosure bolsters the significance of the facts left undisclosed, and also makes the actual bias argument more plausible. In view of the Court's disposition of the disclosure issue, it need not resolve the actual bias claim. It is certainly possible that Positive Software's aggressive conduct in the arbitration and its grandiose damage claims gave rise to the Arbitrator's disdain. *See* Award at 7 ("It involves a saga of how failure to renew an $86,100 software license has led to a claim for $500,000,000 in damages in this Arbitration, and for $38,000,000,000 in Federal Court."). Had the Arbitrator disclosed his prior relationship with New Century's counsel, this Court would not be left wondering

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motion to vacate the arbitration award is, therefore, granted.[24]

CONCLUSION

Arbitration is intended to be an expeditious and less expensive alternative to traditional litigation. This is surely a case study of how that can go wrong. That state of affairs could not obtain without the active participation of both sides. Although the Court hopes that the second arbitration will be expeditious and inexpensive, the Court is not overly optimistic on that point. Given that, the Court would not order a second arbitration absent a firm conviction that it is here required by the law and facts. In view of the second arbitration, counsel are reminded that their duty to represent clients zealously is only one of the

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whether Positive Software earned the Arbitrator's disdain in this case or inherited it from the Intel Litigation. *See, e.g., Commonwealth Coatings,* 393 U.S. at 151 ("[I]t is far better that the relationship be disclosed at the outset, when the parties are free to reject the arbitrator or accept him with knowledge of the relationship and continuing faith in his objectivity, than to have the relationship come to light after the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award."); AAA, Guide to Commercial Arbitrators ("Prompt disclosure gives the parties an opportunity to waive their objections. Such a waiver will bar any subsequent objection to the award on grounds of bias.").

[24] On August 27, 2004, Positive Software moved to amend its motion to vacate arbitration award to assert claims that the award should be vacated due to New Century's fraud in, *inter alia,* failing to produce the November 2000 script for the original LoanForce database. New Century opposes the motion as untimely. Due to the Court's disposition of the partiality issue, the motion to amend is denied as moot. If the Court were to address that motion on the merits, it likely would grant the motion to amend and grant the amended motion to vacate for, *inter alia,* New Century's failure to produce the November 2000 script.

duties that attorneys owe to clients, to the courts, and to their profession.

Accordingly, it is ORDERED that all motions for contempt are denied; that New Century's motion to confirm is denied; that Positive Software's motion to vacate is granted. The parties are further ordered to arbitrate this dispute; in the second arbitration, the parties are directed to make no reference to any ruling of the Arbitrator in the first arbitration and are specifically directed not to advise the new arbitrator, directly or indirectly, of the Award or any portion of the Award. It is further ordered that the arbitrator selected for the second arbitration shall not read or consider in any way any ruling of the Arbitrator in the first arbitration, including but not limited to the Award. It is further ordered that this action is stayed pending conclusion of the second arbitration. The parties are ordered to file no further pleadings in this Court without leave of Court other than (a) motions under Rules 59 and 60, (b) motions incidental to any appeal of this Order, and (c) motions to lift stay. New Century's March 18, 2004 motion to alter is granted; all pending motions to seal are granted; all pending motions not expressly granted in this Order are denied.

SIGNED this 28 day of September, 2004.

/s/ David C. Godbey
David C. Godbey
United States District Court